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McNamara Papers

Chronological file (incoming)
1970 (March - Dec.)

5

488/6/16

12-24-70

INTERNATIONAL BANK
RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

INTERNATIONAL FINANCE CORPORATION

OFFICE OF THE PRESIDENT

1/4

To Mr. Wieczorowski

Bob, you may be ~~interested~~ in reading the attached note on the Indus Basin project.

[signature]

INDUS BASIN AND TARBELA PROJECTS

BACKGROUND

1. The irrigation system in the Indus Basin in West Pakistan commands an area of 33 million acres, of which 24 million acres are irrigated annually. Soon after partition in 1947 India asserted rights over the waters of the eastern rivers (Sutlej, Beas and Ravi) including the right to stop supplies to Pakistan from these rivers. India's assertion of this right constituted a major threat to the future of irrigated agriculture in Pakistan and became a major water dispute between the two countries. The dispute on water rights was finally settled, through the good offices of the World Bank, with the signing of the Indus Waters Treaty in 1960 by India and Pakistan. Under this Treaty Pakistan undertook to give up its water rights in respect of the three eastern rivers, in exchange for a vast program of replacement works to replace water drawn from the three eastern rivers by water from the three western rivers, the Indus, Jhelum and Chenab.

2. The program of works, known as the Indus Basin Project, comprised two dams, Mangla and Tarbela, both much bigger than any other earth fill dams constructed elsewhere in the world, 400 miles of new link canals, six major barrages and the remodelling of three existing link canals and two barrages. The construction of these works, including Tarbela, involves the movement of over 700 million cubic feet of earth and the use of more than two million tons of cement. It has been estimated that the excavation required would be equivalent to that required for six Suez Canals. The current estimated cost of these works, including Tarbela, is $2.2 billion (including duties).

3. To finance these works the Indus Basin Development Fund was set up in 1960 with contributions from the U.S.A., U.K., Germany, Canada, Australia and New Zealand, and with loans from the U.S.A. and the World Bank and a fixed contribution by India. In 1964, supplementary contributions and loans were arranged in view of increases in the cost estimates and it was arranged that Pakistan would meet the local currency costs. A dam on the Indus was excluded from the Indus Basin Project, but provision was made for a study to be undertaken (now known as the Lieftinck Study) to determine whether a dam on the Indus (at Tarbela) would be technically and economically feasible, and for the balance of the Indus Fund to be applied to a feasible water development project. The findings of this study were that the Tarbela Dam project was feasible. Arrangements were made early in 1968 to supplement funds expected to remain after the other Indus Basin works had been completed, then estimated at $324 million, by additional loans from the U.S.A., U.K., France, Italy, Canada, and the Bank to meet the foreign exchange costs, estimated at $492 million. Pakistan undertook to meet the local costs estimated to amount to the equivalent of $440 million (including customs duties).

4. Under the terms of the Indus Basin Development Fund Agreement 1960, the Indus Basin Development Fund (Supplemental) 1964 Agreement and the Tarbela Development Fund Agreement 1968, the Bank is the Administrator of the Indus Basin Development Fund and the Tarbela Development Fund.

PROGRESS OF THE WORKS

Indus Basin Project (IBP)

5. With the completion of the Chasma Barrage by March 1971, all the major works of the Indus Basin Project (apart from Tarbela) will have been completed. Most of the works have been completed on or ahead of schedule, and Pakistan ceased to be dependent upon supplies from the Eastern Rivers ahead of the schedule provided by the Indus Waters Treaty 1960. It was not necessary, therefore, to take advantage of provisions for the extension of the "Transition Period" (period allowed for the construction of the replacement works) and the payment of the penalty to India which the extension of the Transition Period would have entailed was avoided. Expenditures to November 30, 1970, amounted to $1,226 million, of which the foreign exchange costs amounted to $580 million. Apart from expenditure on Tarbela, it is currently estimated that about $60 million remains to be disbursed over the next two years, of which foreign exchange costs may amount to $25 million.

6. This immense program of works has been carried out with remarkably few major unforeseen difficulties.

Tarbela Dam Project

7. The Tarbela dam when completed will be the largest earth filled dam in the world. The principal element of the project is an embankment 9,000 feet long with a maximum height of 470 feet. There will be a powerhouse for the installation, ultimately, of generating capacity totalling 2,100,000 kw. Four half-mile long tunnels through the right rock abutment will serve for the diversion of water during the last phase of construction. Later they will be used for power and for irrigation releases. The reservoir created by the structures will have a gross storage capacity of 11 million acre feet. The main embankment dam and two auxiliary dams will contain 186 million cubic yards of rock - about two-thirds as much as the initial excavation for the Panama Canal.

8. The main civil works contract - the largest single contract of its kind ever awarded - which was awarded in May 1968, is being carried out by Tarbela Joint Venture, a consortium of Italian, French, German and Swiss contractors.

9. The works are scheduled to be completed by 1976.

10. By October 1970, the first diversion of the river had been completed on schedule. The contractor had fallen behind schedule on a number of items

mainly through difficulties in starting up an intricate and extensive system of soil processing plants and conveyors. But improved progress is now being made and there is a prospect that the contractor will get back on schedule as the work proceeds.

11. Periodically, engineering and design problems arising as construction proceeds are reviewed by a panel of consultants of international repute. The problems that have arisen so far are of the kind that should be expected in carrying out a project of this kind and size. So far, changes in the work program have not been significant enough to warrant changing the initial cost estimates of the project or the scheduled date for completion.

12. By the end of November 1970, expenditures from the Tarbela Development Fund had amounted to $330 million, of which $165 million was in foreign currency, leaving approximately $600 million to be disbursed, of which about $330 million is the foreign currency component. Upwards of $270 million equivalent remains to be provided by Pakistan to meet the local currency costs.

PROJECT SUPERVISION AND CONTROL OF EXPENDITURE

13. To carry out its obligations as Administrator of the Indus Basin Development and Tarbela Development Funds, the Bank has taken particular pains to ensure that the technical and financial administration of the projects are carefully and closely supervised. The responsibilities of the Bank, as the Administrator, in the control of the use of the funds provided by the contributors and in making arrangements for disbursements from the Funds are set out in the Indus Basin Development Fund Agreements of 1960 and 1964 and the Tarbela Development Fund Agreement 1968.

14. The works financed out of the Funds are for the benefit of Pakistan. Contracts, in terms approved by the Bank as Administrator, and awarded after international competitive bidding, have been entered into by a designated Government agency. The agency designated by the Government was the West Pakistan Water and Power Development Authority (WAPDA), an autonomous corporation created mainly for this purpose. In carrying out the project works, WAPDA is assisted by General Engineering Consultants and, for each of the main projects work, Project Consultants appointed to be responsible to WAPDA for project design, the preparation of contract documents, the supervision of construction and the certification of payments. WAPDA's accounts in respect of the project works are audited by a local firm of Chartered Accountants.

15. In October/November 1960, a Bank team together with representatives of Sir Alexander Gibb & Partners and Coopers and Lybrand, visited Pakistan to review WAPDA's organization in relation to the system of works to be carried out, to formulate procedures and methods of control to ensure timely completion of the works, to prepare measures to ensure financial control and administration, and to establish standard conditions of contract for main contracts to ensure that the bids received for the works were on a comparable basis. In February 1961, to assist the Bank in carrying out its functions as Administrator, the Bank appointed Sir Alexander Gibb & Partners, Consulting Engineers, and Coopers & Lybrand, Consultant Accountants. There have been

periodical reviews by the Bank of the scope of the work of the Consulting Engineers and Consultant Accountants, and of the allocation of staff in relation to variations in the work load.

16. In accordance with the provisions of the agreements establishing the Funds, semi-annual reports are prepared and circulated to the contributing governments. These reports, in addition to providing information about the progress of the works, also summarize the contracts let amongst other information concerning receipts and disbursements, and balances in the Funds.

17. In the Bank, a standing working party made up of senior representatives of the Projects, Legal, Controllers and Area Departments, reviews progress and deals with problems as they are reported by the Consultants. Periodically, usually twice a year, a joint mission comprising representatives of the Bank, Gibb and Coopers, visits Pakistan to review outstanding problems and the action needed with WAPDA and the Government.

CONCLUSION

18. In short, to secure the successful completion of this massive scheme of development, the procedures followed in supervising the execution of the works and in controlling disbursements, have been based on usual Bank procedures. But in view of the magnitude of the project works and the need to be able to satisfy other contributors that the Funds were being properly administered, the Bank has maintained a much closer and more detailed control of expenditure than is usual for ordinary Bank projects.

South Asia Department
December 24, 1970

488/6/15

वित्त मन्त्री, भारत
FINANCE MINISTER
INDIA.

New Delhi,
December 2, 1970.

Dear Mr. McNamara,

You will recall that during our meeting in Copenhagen I had invited you to come to India at your convenience.. You were good enough to say that some time towards the end of January or the beginning of February 1971 might be convenient from your point of view. This is just to confirm that we would be very happy indeed if you could visit India at the time suggested by you in Copenhagen or at any time thereafter which you may find convenient in view of your other engagements. The detailed programme and the timing of the visit could be settled in consultation with Dr. S.R. Sen. We hope that apart from Mrs. McNamara, you would feel free to bring any other member of your family who may wish to accompany you.

My colleagues and I are looking forward to your visit to India.

With kind regards,

Yours sincerely,

(Y.B. Chavan)

Mr. Robert McNamara,
President,
International Bank for
Reconstruction & Development,
WASHINGTON, D.C.20433, USA.

President has seen

488/6 /14

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

H-4

TO: Mr. R. McNamara (through Messrs. Chadenet and Cargill)

DATE: November 24, 1970

FROM: R. Sadove

SUBJECT: East Pakistan Reconstruction Program

The attached memorandum with annexes represents a Reconstruction Program prepared by our recent Mission at the request of the Governor of East Pakistan. The program has received the support of the Central Secretary of Natural Resources and Industries on behalf of the President of Pakistan, as well as that of the Governor of East Pakistan, E. P. Chief Secretary and the new Chairman of the E. P. Planning Board. The Central Secretary asked me to inform you that the President is particularly anxious to get started with certain reconstruction programs such as those involving shelters, water supply and telecommunications. The East Pakistan Government has clearly indicated that they wanted this to be treated as a priority program on a similar basis as our Action Program, that is to be carried out under the leadership of the World Bank which would call upon the financial support of other international organizations, the members of the Consortium and other interested nations.

No matter what you decide regarding the Bank's role in coordinating such a general program, selected items within this program could easily provide the basis for a $25 million IDA credit. I did not, however, inform the East Pakistan Government of the amount that we were considering for IDA financing.

The program as it now stands was prepared jointly by our mission with the cooperation of all relevant departments of the East Pakistan Government under the direction of Mr. Salahuddin, Secretary of Agriculture, who was selected for this purpose by the Chief Secretary. I note that the East Pakistan Government has shown extraordinary cooperation in these efforts. Some department heads and other senior officials have literally worked through the night with us in executing this work.

The extent of the cyclone tragedy and the urgency of the present situation demanded that the framework for such a program be drafted within several days and nights. The Governor and the Central Secretary of Natural Resources both personally asked me to place the program before you as soon as I could return back to Washington.

I believe the program is generally sound and reasonable. It is designed to employ the survivors in rebuilding their economy and to translate those efforts into income with which they can obtain food and other necessities. The program consists of the top-priority projects from a human and economic perspective, and the projects are for the most part well-conceived with cost estimates that are the correct order of magnitude. I would add, however, that I believe, in the case of IDA participation, each sub-project should be evaluated individually after the Board has approved the credit, but before disbursements are made on the sub-projects involved. It is important to note that some of these evaluations must take place in the next few weeks -- for example, for the project to supply fresh water. Our staff could do these evaluations in conjunction with a new Reconstruction Board being appointed by the Pakistan Government under the Chairmanship of the Governor. It is my understanding that the Pakistan Government will also soon appoint a Reconstruction Program Administrator to coordinate such a program in the field.

I feel on both human and professional grounds that the Bank should act immediately because I do not see any other agency that can lead the way in the context of this great tragedy.

488/6/13

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT
ASSOCIATION

INTERNATIONAL FINANCE
CORPORATION

OFFICE OF THE PRESIDENT

11/14

To Dr. Chenery
Hollis, this is an excellent paper.
Note for your file — some parts of this might be used in the paper we are preparing for Irish Frank's committee.
Bob

VOECD
Employment/Unemployment

OCDE

ORGANISATION DE COOPÉRATION
ET DE DÉVELOPPEMENT ÉCONOMIQUES

OECD

ORGANISATION FOR ECONOMIC
CO-OPERATION AND DEVELOPMENT

Téléphone : TROcadéro 76-00 Télégrammes : DEVELOPECONOMIE 2, rue André-Pascal, PARIS-XVIe

Comité d'Aide au Développement

Development Assistance Committee

October 20, 1970

Mr. Richard H. Demuth
Director
Development Services Department
I.B.R.D.
1818 H Street, N. W.
Washington, D. C. 20433

Dear Dick:

I think you are familiar with the exchange of letters I had last spring with McNamara on the subject of Tidewater IV (mine of April 22, 1970 and his of May 6, 1970).

In the light of the continuing interest in the unemployment problem, which was at the top of my list then, it strikes me that the enclosed stimulating paper, given by Hans Singer at the recent Cambridge, England conference on this subject, would serve as a good basis for discussion. Do you think McNamara would find it useful?

If he will be in town, I'd like a few minutes with him November 10-12. Ernie Stern is making some other appointments and you might check with him on exact timing.

4:00 P.M. Thur Nov. 12

~~to be confirmed by Polly~~ ~~Hales tomorrow 10/27~~ Confirmed 10/27

Sincerely,

Edwin M. Martin
Chairman

Miss Troy
101-28676

4:45 with RHD on Nov. 12th

Orig of Enclosure to Chenery 11/16/70

OECD

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

OCDE

ORGANISATION DE COOPÉRATION ET DE DÉVELOPPEMENT ÉCONOMIQUES

2, rue André-Pascal, PARIS-XVIe Télégrammes : DEVELOPECONOMIE Téléphone : TROcadéro 76-00

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Sincerely,

Edwin M. Martin
Chairman

Ad 70

INTERNATIONAL POLICIES AND THEIR EFFE ON EMPLOYMENT

H. W. Singer

It is notoriously difficult to measure unemployment in ldcs in terms which make it comparable with unemployment in the richer countries. Its forms and apparitions are too different, and I agree with Gunnar Myrdal, Michael Lipton, Paul Streeten and others that we must be wary of transferring uncritically western concepts to the different Third World. However, we must be equally careful not to jump from the legitimate refusal to apply First World concepts - or Second World World concepts for that matter - to Third World problems, to the illegitimate assumption that unemployment and under-employment in open and disguised forms do not exist, or are not serious, merely because they cannot be measured by familiar concepts and caught by familiar definitions, or because the data are lacking. Without labouring the point, for my present purposes I shall simply assert:

(a) that unemployment is extremely serious in the ldcs;

(b) that it is much more serious at present in the ldcs than in the richer countries;

(c) that on reasonable definitions unemployment is of the order of magnitude of 25-30% in many ldcs, and 20-25% in the overall picture;

(d) that it is serious, more or less equally so, both in its rural and urban manifestations;

(e) that unemployment has become increasingly serious in the last 10-20 years;

(f) that on present indications it is bound to increase further, unless counter-influences appear (which must probably include a vigorous and balanced development of science and technology in directions more relevant to the ldcs and their factor endowments, and in the longer run a slowing down of population growth).

All this amounts to saying that the present context of relations between richer countries and ldcs has been at least consistent with a global disequilibrium in the incidence of unemployment in the two groups of countries; say 3-5% in the rich countries and 20-30% in the poor countries. The thesis of this paper is to suggest:

(i) that the present relations between rich and poor countries are not only <u>consistent with</u>, but also <u>contributory to</u>, this disequilibrium, with heavy persistent unemployment in the ldcs; and

(ii) that reforms in the present relations of the two groups of countries are among the counter-influences, mentioned in (f) above, which are required to improve the situation, or even to prevent it from worsening.

We shall consider the possible contribution of rich/poor countries' relations to ldc unemployment under the headings of (1) Trade; (2) Aid; (3) Private Investment; (4) Science and Technology; and (5) International Liquidity.

(1) Trade

It is no accident that trade has been placed first. As an economist I am bound to say that the main avenue along which one would look for a major contribution to the solution of the unemployment problem in developing countries lies in trade. Traditionally, in the thinking of economists, trade has been the method by which each country exports, through the commodities produced and traded, those factors of production which it has in relative abundance, while it imports, again through commodities, those factors of which it is relatively short. For the developing countries this would mean that through trade they would find an outlet for their abundant labour, and be enabled to remedy their deficiencies in capital through imports.

Unfortunately, trade has not in fact played this major role conceptually attributed to it. But it still remains true that potentially this could be the case. The developing countries, with a good deal of support from enlightened opinion within the industrial countries as well, are putting forward in UNCTAD and elsewhere requests that their labour-intensive manufactures should be admitted to the huge markets of industrial countries on a duty-free or preferential basis. Similarly, freer access of agricultural commodities and other raw materials is also under debate. When we think of the tremendous markets involved, and the tremendous rate of expansion of international trade as a whole, in which the developing countries have so conspiciously failed to participate, one cannot help being impressed by the vast potential improvement in the employment picture of the developing countries which expanded trade could produce.

It is not easy to quantify hypothetical situations which cannot be isolated from other events and trends. However, I am going to stick my neck out and risk the guess that if the share of ldcs in world trade had been kept up since 1955 by a reduction of agricultural protectionism and trade barriers in the richer countries, the employment volume in the ldcs could be about 10% higher than it is now. That would be say 82½% of the labour force instead of 75%, and unemployment would be 17½% instead of 25%. Moreover, if this hypothetical assumption of a fully maintained share in total world trade could be projected into the future, and if world trade should continue to expand as rapidly as in the past decade, the establishment of this condition might prevent unemployment in the ldcs from rising in the next decade, even in the presence of a capital-intensive technology and a certain rapid increase in the labour force. But this is a big and extremely hopeful assumption to make. Notwithstanding favourable votes in UN bodies and acceptance of global targets which really depend upon such action, are we in the richer countries really ready for it? No doubt we could ourselves benefit in the long run by concentrating on the more sophisticated lines of production (but by the same token perpetuate global dualism and technological colonialism). But the case of aid should warn us that demonstrations of long-run advantage do not seem to be particularly compelling in eliciting from taxpayers, parliaments, civil services and politicians of richer countries any great willingness to make what looks like one-sided 'concessions' even though the sacrifice may be more apparent than real, and transitional rather than lasting. Perhaps real sacrifices could be more readily elicited than the inconveniences of adjustment?

The trouble of course is that the burden of adjustment, if not properly handled, will tend to fall on vulnerable groups most directly in line of competition with the potential exports of the ldcs - the elderly textile worker in Lancashire, the farmer, the older more labour-intensive firms. The necessary adjustments and compensations should certainly be within the power of the richer countries, as well as being in their own interest. Nobody wants to solve the problems of the ldcs on the backs of the poorer people within the richer countries - but then we should also stop trying to solve the problems of our poorer (or simply more vocal!) sectors on the backs of the even poorer ldcs.

In this paper which deals with "International Policies" we naturally look at the action required by the richer countries, but let us remind ourselves that the ldcs may also have to make painful and difficult adjustments in their present policies and outlook to take better advantage not only of the present, but also of any potential larger future export opportunities. This requires outward-looking policies, willingness to take risks, to study foreign markets and tastes. It takes two to export, and perhaps it takes a dash of Japanese! And the mentioning of Japan could serve as a reminder that the development of a prosperous home market base has never yet hurt a country in developing its exports as well. But there is also a counter-lesson from Latin America: the building up of a pseudo-prosperous home market under the banner of import substitution may be more of a hindrance than help in export development.

Hal B. Lary of the National Bureau of Economic Research in New York has found that the following industries stand out as particularly labour-intensive in relation both to skills ("human capital") and to physical capital: apparel and related products; leather and leather products; lumber and wood products; textile mill products; furniture and fixtures; miscellaneous manufactures; rubber and plastic products. Trade concessions in these products (which I have listed in more or less descending order of employment-intensity in terms of unskilled labour) would have particularly strong employment impact in the ldcs, and relieve wage pressures and tight labour markets in the richer countries. Is there not a ready-made agenda here for international action? If the ldcs can only provide the skills, even while lacking the physical capital, a number of other industries could be added as being employment-intensive in the ldcs: fabricated metal products; printing and publishing; electrical machinery; non-electrical machinery. This list of eleven employment-intensive industrial groups _prima facie_ suited for export from the ldcs would still leave the richer countries with nine industrial classes which are both skill- and capital-intensive, and hence _prima facie_ suitable for _their_ exports.

The case made here for international trade concessions to the ldcs specifically directed towards employment promotion is of course additional to the more general case for trade development as a way of reducing their foreign exchange bottlenecks and speeding up their general rates of growth and investment. This more general case has been amply made in UNCTAD, the Pearson Report, and elsewhere, but by comparison perhaps not much attention has been given to how to obtain maximum employment impact through trade concessions. The scope is certainly enormous, considering that imports of labour-intensive products from the ldcs are only a small fraction of rich countries' total imports of such products, and only a fraction of that fraction when related to their total consumption of such products. Even a target of say 10% of the total <u>increase in</u> the consumption of such products to be imported from the ldcs would have highly important employment impact.

But all this is 'potential', i.e. pie in the sky. Meanwhile the ugly skeleton of the scandalous international cotton "agreement" rattles its bones to remind us of reality, and of <u>one</u> reason for 25% unemployment in the ldcs! To this we should add, as equally misleading, the moderate-looking nominal tariff rates on processed and manufactured products from the ldcs which conceal the real, and much higher, effective taxes on value added by employment.

(2) <u>Aid</u>

Here once again we must distinguish between the general case for additional aid, as contributing to fuller employment in the ldcs, and the specific case for adjusting the forms and methods of aid so that a given volume of aid becomes more 'employment-intensive' in its impact. The general case is no doubt valid (within certain limits and with certain qualifications): increased aid, say the achievement of the Pearson targets of 1.0% and 0.7% of GNP for total financial flows and public aid, would increase the rate of investment and growth, and <u>ceteris paribus</u> increase employment.[1] Improvements in the terms of aid, untying, more grants and anything that leads to more effective use of aid would have the same presumptive favourable effect on employment. The limits and qualifications mentioned include a possibility such as the following: if the additional growth and employment created by more aid are in the urban/modern sector, then the increase in the number of urban jobs created might swell the flood of migration to the cities to such an extent that unemployment, at least in its open and urban forms, could actually increase. This possibility, based on East African conditions, is inherent in Michael Todaro's much-discussed model.[2] Another possibility would be that the higher

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(1) This would be questioned by some, either on more general grounds that aid is "bad" for ldcs, or on more specific grounds such as by A. Qayum in "Long-term Economic Criteria for Foreign Loans", <u>Economic Journal</u>, June 1966.

(2) "A Model of Labor Migration and Urban Unemployment in Less Developed Countries", M. Todaro, <u>American Economic Review</u>, March 1969, pp. 138-148.

growth rate and investment rate in the urban/modern (and capital-intensive) sector could be accompanied by such a change in the overall composition of investment, by drawing complementary domestic resources out of the rural/traditional/ service sector (largely labour-intensive), that overall employment is diminished rather than increased. The possibility of this applying to Colombia has been pointed out by the ILO mission under the World Employment Programme, led by Dudley Seers.(1) However, broadly speaking, more aid, or more effective aid = more employment, although the conventional aid/employment ratio is almost certainly unimpressive.

How can the aid/employment ratio be improved? This is the special relationship between international aid policies and employment with which we are concerned here. Space limits us to an enumeration of changes in international aid policies which could improve the employment impact of a given volume of aid.

(a) Aid is now available predominantly for the import component of projects, largely equipment. This puts an artificial premium, as far as the ldcs are concerned, on preferring capital-intensive projects to more labour-intensive ones, or for any given project preferring a more capital-intensive (import-intensive) to a more labour-intensive technology. Both these effects reduce (or possibly pervert) the employment effect of aid. Aid should be equally available for local expenditures on projects (including local equipment). This could be done either by giving aid as a fixed percentage of total project costs, whether 100% or 50% or 25% of the total cost, or alternatively by giving aid on a programme or general budgetary basis. The Pearson Commission has recommended that aid givers remove regulations which limit or prevent contributions to the local cost of projects, and make a greater effort to encourage local procurement wherever economically justified.(2) This recommendation deserves full support. In particular, it is to be hoped that the multilateral aid sources will pay full attention to it; so far they have been more in the rear than in the van of the faint movement in this direction.

(b) Aid is more readily available for investment in the urban/modern sector than in the rural/traditional sector. This has the dual effect of raising the overall capital/output ratios by changing the investment mix in the direction of the more capital-intensive urban/modern sector; and of intensifying rural/urban migration by increasing the rural/urban income differential and the job attractions of the towns. Both these effects tend to reduce the employment impact of aid. The aid/employment ratio could be improved (lowered) if more aid were available for the rural/traditional sector (not necessarily agricultural but inevitably much of it directly agricultural and most of it agriculture-related). Here again, we are pushing at an open door in so far as most aid programmes, especially the World Bank, have announced an intention to

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(1) Towards Full Employment, A Programme for Colombia Prepared by an Inter-Agency Team organised by the International Labour Office. ILO, Geneva, 1970.

(2) Partners in Development, Report by the Commission on International Development, Praeger, New York, Washington, London, 1969, p. 177.

shift more aid into the agricultural sector, and into rural development. However, the implementation of such a policy will be more difficult than the policy-framers realise. Often the aid would have to be on a programme or budgetary basis, and channelled through local financial institutions in order to overcome the logistic difficulties of channelling aid into a multitude of small widely dispersed projects conducted under unfamiliar and unsophisticated conditions of bookkeeping, expenditure control, etc.

(c) Aid is more readily available for a few large projects rather than for a variety of smaller projects. Smaller projects however are both more likely to be employment-intensive and also more likely to be found in rural or small town locations where they reduce migration to the cities and consequently urban unemployment. There is of course a certain fungibility in that external aid for large projects may release local resources for smaller-scale projects (or vice versa). This fungibility however may work in reverse if the external aid covers only a relatively small part of the total cost of the large-scale project while the rest may have to be covered from complementary local resources. The best approach would be either to channel aid through local financial institutions or to place it on a programme or budgetary basis.

R. seems to avoid this [illegible] his problem [illegible]

It will be seen that the policy prescriptions under (a), (b), and (c) above coincide quite closely. In fact it may be said that present aid practices form an anti-employment syndrome, while the corrective measures required also form a single syndrome.

(d) The employment impact of aid also suffers from a confusion within the present aid system of promoting new growth or development as distinct from promoting new development <u>projects</u>. It is a great deal easier to obtain aid for a new project rather than for the expansion of an existing project, or the repair and maintenance parts needed to keep existing projects going, or the import of raw materials required for their operation, or the additional expenditures (largely local wages) which would be needed to utilise existing plant more fully by multiple shift work. There has been some improvement particularly in the direction of providing aid for import of required raw materials, but the statement is still broadly true. As a result we have the extraordinary spectacle of scarce capital standing idle or under-utilized although no doubt deficiencies in management, income distribution, planning etc. also play a large part in this. Aid given for the more effective utilisation of existing capital would nearly always be much more employment-intensive than aid given for the introduction of new capital. In fact the kind of aid here advocated would represent the best kind of intermediate technology - capital-saving yet without arousing the antagonisms conjured up by the idea of a 'different' technology.

(e) Aid for the financing of public works, and especially of rural public works, is almost impossible to obtain, partly because there is no single project and partly because the expenditure involved is local. Food aid is a form of aid particularly useful for the financing of public works and labour-intensive development in general. No doubt food aid can be harmful if it depresses prices for local farmers or leads to a slackening of domestic effort in food production. But it would be throwing out the baby with the bath water to go slow on food aid rather than administer it in such a way that it has no undesirable side effects. It is to be hoped of course that food aid, which essentially does not impose any real sacrifice on the donor of the surplus food, would be considered as additional to other aid rather than competitive with it. Perhaps for this reason it should not be counted within the 1% and 0.7% Pearson targets.

(3) Private Foreign Investment

The present employment impact of private foreign investment is reduced by a number of factors and could be increased by changing them. A bare list must suffice here.

(a) A foreign firm, particularly a multinational firm, will almost automatically fall back on the capital-intensive technology available to it internally through the research products, know-how, patents , etc. of the head office or parent company.

(b) A foreign firm will not wish to be troubled with the incomprehensible and politically-charged problems of handling large masses of local labour, deciding who should be employed and who should be refused employment, etc. The employment of capital is the line of least resistence.

(c) A foreign firm will be faced with a demand for wages much higher than the prevailing local labour situation and the resource endowment of the country would justify. To push up wages against foreign firms is almost a patriotic duty, and will understandably be supported by the local government as one way of keeping the money in the country and reducing the repatriation of profits.

(d) Where one of the original motives of the foreign investment was to use the local subsidiary or licencing agreement as a foothold for selling equipment, spare parts, operational raw material, etc., the provision of secondary local employment by ordering locally will be absent or greatly reduced.

This is by no means a full list, and no doubt there are also countervailing factors at work - including deliberate policies of a number of foreign firms - but it will help to indicate some of the changes in foreign investment policies which might be needed if we are to increase its impact on local employment.

(4) Science and Technology

Although problems of science and technology are less discussed (at least by economists and politicians) than trade, aid or investment, in fact this is the area in which the rich countries have perhaps the most powerful impact - for better or worse - on employment in the ldcs. The dominant fact of international life is that it is the richer countries, with one third or less of the world's population, which account for 99% of the world's scientific and technological innovation. Admittedly, R & D expenditures (on which the 99% figure is based) is a less than satisfactory input proxy for the output of innovation, and in addition it covers only one segment of the relevant inputs; but it is the best we have. In some ways, it even understates the dominance of the richer countries: such is this dominance that even the R & D expenditures of the ldcs are largely devoted to making a marginal contribution towards "extending the frontiers of knowledge", in ways and in directions automatically determined by the conditions and factor proportions of the richer countries.

In the Sussex Manifesto -- prepared by a group of consultants to the UN Advisory Committee on Science and Technology meeting at the University of Sussex last year(1) - we described this phenomenon as the 'internal brain drain', and as perhaps more important and dangerous to the ldcs than the external brain drain (visible geographical movement of highly qualified people) which has attracted so much more attention. It is on account of this internal brain drain as well as on account of the low efficiency of small and scattered R & D expenditures without adequate infrastructure and equipment (also discussed in the Sussex Manifesto), that one must be rather sceptical of the value of any targets of increasing the local R & D expenditures of ldcs from 0.2% of their GNP to 0.5% or any other figure, when such proposals are made in isolation.

It is only within the context of planned global change in the composition and direction of scientific and technological progress that such a target assumes a constructive meaning. And it is again because of the dominance of rich-country technology which not only dominates the R & D inputs and controls the R and D infrastructure, but also sets the tone and determines what is considered as 'progress' or 'modern' or 'efficient' even within the ldcs - however contrary to their true interests - that any such planned global change must include a restructuring of the R & D priorities within the richer countries. It is they who must redefine what constitutes 'progress' and where the 'frontiers of knowledge' lie. This they must do in such a way as to include more of the things which are useful to the ldcs (production on a smaller scale, simpler product design, tropical product improvement, protein foods for young children, etc.), and fewer of the things which are directly harmful to them (certain developments in synthetics, automation, machinery with extremely high repair and maintenance requirements, etc.). The target of the Pearson Report that the richer countries should shift 2½% of their R and D expenditures in this direction is an important, if modest, beginning.

For the purposes of our present discussion it should be noted that any such change in direction would be bound to give much higher priority to employment intensity, capital-saving and reduction of sophisticated skill requirements in operation, maintenance, etc. And let us not hear too much of the old <u>canard</u> that capital-intensity is good for ldcs because it economises in skills. All the evidence is to the contrary; and the landscape of the ldcs is strewn with the evidence of this fallacy in the form of under-utilized, broken down, idle, high-cost 'modern' capital equipment.

Hopefully in later years those after us will shake their heads incredulously at how we set about this business. We take technologists and other experts involved away from their familiar environment and drop them in another country (usually with insufficient briefing), leave them to find houses to live in and schools for their children, to find local counterparts, to find their ways in unfamiliar surroundings, and all too often whisk them back just

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(1) <u>World Plan of Action for the Application of Science and Technology to Development</u>, United Nations Document E/AC.52/L.68 of 19 October 1969.

when they become effective. If this reads like a parody, few with experience would deny that it contains elements of truth.

Surely, the first step in a global partnership must be to use the wonderful and dreadful machinery of science and technology where it is and where it can operate most effectively, and realise its potential blessing for world economic development. The sending of experts abroad and the building up of an indigenous scientific and technological capacity within the ldcs must take place simultaneously, and in alignment with a change of direction of progress within the dominant richer countries. The $2\frac{1}{2}\%$ suggested by the Pearson Report is less than one-twentieth of what is now spent on military, space and atomic technology, less than what the richer countries will have added to their R & D expenditures between the June day in 1970 when this is written and the end of the same year.

And once again, as with trade and aid, the thinking within the ldcs will have to change as much as the thinking in the richer countries. Feasibility studies of projects will have to be based on spectra of technology and on pricing systems which reflect the real resources and needs of the ldcs. At present, any such movement is only too easily resisted as evidence of technological colonialism, on the grounds that the ldcs are permanently to be fobbed off with an inferior second-class technology. Tragically, exactly the opposite is true: the present dominance of a technology appropriate for the rich countries, a dominance obtaining within the ldcs no less than without, ensures a continued handicap for the ldcs. The present rates of population increase, the present capital-intensive trend of technology, and productive full employment are three things which simply cannot co-exist. Something has to give - and at present it is employment.

(5) International Liquidity

Here, of course, attention should be paid to the great step forward taken by the world community by the creation of the Special Drawing Rights. A little of that progress has rubbed off on development even at present, in that the ldcs, contrary to the original intentions, at least participate in the SDRs to the extent of their IMF quotas. Perhaps more important is the widespread conviction which has emerged that now the SDRs have been safely - and one hopes irrevocably - established, their potential for world development can be safely utilised without damage to their original and primary purpose. The technique for doing this is less important than the decision itself, although the opportunity to strengthen multilateral channels seems too good to miss - killing three birds with one stone!

The balance of payments objection to increased aid to the ldcs was never too convincing, except possibly as a question of re-distributing the overall burden of aid among the richer countries. It could always be pointed out that as long as the ldcs did not use aid to increase their foreign exchange reserves - and with exceptions the main criticism of their policies was exactly the opposite - there was never a valid balance of payments argument against increases in overall aid. Now, with the creation of the SDRs we can go a step further. The richer countries, taken together, will not only not have a balance of payments deficit, but they will in fact have a positive balance of payments surplus. The case for linking this new progress in international relations with a step forward in development assistance seems very strong - but what better direction than to link this even more specifically with the objective of providing constructive employment for the young in the ldcs?

HWS/CJ

10/22 To Mr. Cargill

PAK

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Polly's copy

488/6/12

TO: Mr. Robert S. McNamara

DATE: October 15, 1970

FROM: I. P. M. Cargill Library!

SUBJECT: Pakistan - Country Program Paper

CONFIDENTIAL

The present schedule calls for a meeting with you on November 2 to review the Country Program Paper for Pakistan. As it is now expected that Pakistan will devalue around the end of October, I do not think that a meaningful paper can be prepared for a meeting of that date.

In particular, we are not able now, with devaluation looming ahead, to prepare a meaningful lending program. One reason is that devaluation will inevitably require a thorough review of the current annual development program and plans for next year, as prices will change and priorities have to be reconsidered. Another, and more important, reason, is that we do not know at the moment what resources the Government will have available for its development program after devaluation. Our latest assessment of the budgetary outlook indicates that the rupee availability will not permit much of an increase in development spending over last year's level, if any, thus confirming our worst fears about the budget. Further, it appears that the exchange reform, as now agreed with the I.M.F., will entail a further substantial cut in the development program as rupee resources will be preempted by wide-ranging subsidies to be introduced to cushion the effect of the reform and by the increase in rupee cost of Government exchange payments. I have written to Dave Gordon (copy attached) asking him to call on the Finance Minister to explain our concern and urge that the subsidies now contemplated be reduced and measures taken to raise additional revenues to protect the development program.

By the end of October, we should know broadly what the Government intends to do with respect to the budget. We should also have a fairly good idea what support the Consortium will give to Pakistan for the exchange reform. Our resident staff in Islamabad and Dacca has already done a good deal of preparatory work on the budget. Nonetheless, I expect that it will be fairly close to the end of the year before the necessary work on revising the current development program and reassessing the outlook for next year's budget will be completed.

I therefore propose postponing your review of the Country Program Paper to a date as early in the new year as we can manage in the circumstances as they emerge.

OK -
Schedule at least a review of FY 72 + FY 73 lending program on or before 1/6/71
RMcN

October 9, 1970

SECRET

Mr. David L. Gordon
IBRD
P.O. Box 1025
Islamabad, Pakistan

Dear Dave:

I spoke to the IMF yesterday to learn what came out of their discussions with the Pakistanis in Copenhagen in the week following the Annual Meeting. In brief, there is now an agreed draft of a letter of intent - broadly following the usual lines of such agreements, including restrictions on credit - to serve as the basis for a stand-by agreement of $125 million. Unfortunately, the contents of this agreement are not such as to give much cause for satisfaction. Indeed, there are two aspects of the reform as now proposed which disturb me greatly. Let me explain in some detail what my problems are because I want you to talk to the Government about them.

What disturbs me most is the impact of the reform on the budget. As you know, I was quite unhappy about the Government's failure in June to take decisive action in raising additional revenues. Information prepared at our request last week by your people in Islamabad and Dacca about the current budgetary outlook broadly confirms our earlier fears, indicating that at best total public development expenditures this year will come to Rs. 660 crores, as against a gross program of Rs. 770 crores and last year's actual outlays of Rs. 620 crores. This by itself would hardly amount to giving the Fourth Plan a very auspicious start and would raise questions in my mind about the realism of the assumptions on which we are proceeding in preparing the action program for East Pakistan. I am now told by the IMF that the Pakistanis have estimated the reform of the exchange system to reduce the resources available in the budget for development by as much as Rs. 95 crores. Claims on the budget would result from various subsidies on imports of foodgrains, edible oil, fertilizer and other so-called essentials (Rs. 94 crores), net reductions in import duties (30 crores) and, of course, the sharp increase in the exchange rate for debt service payments, defense, and other Government imports and payments. These claims would be partially offset by additional revenues arising out of the reform - principally export duties and exchange taxes - but the net effect is, as I said above, estimated to be a substantial reduction in resources available for development. As far as we know, there is no intention on the part of the Government to make up for this impact by additional revenue measures; the IMF says that they tried but failed to move the negotiators on this point. As a result and provided the Pakistani estimate is reasonably accurate, we now face the prospect of a further drastic cut in the development program to, say, Rs. 565 crores. I suspect that not only would such a cut in development outlays fall disproportionately on East Pakistan, but also the regional composition of Government expenditures would shift in favor of West Pakistan because a very large part of the increase in non-development expenditures - defense, debt service, fertilizer subsidy - would be on behalf of the West Wing. I am not sure how the Centre expects to be able to persuade East Pakistan to swallow such further cuts, but there is no question in my mind that if the Government sticks to its present intentions, our position in arguing with the Consortium about support for the reform will be weakened considerably. Furthermore, I simply cannot see how in these circumstances we could go ahead with the action program for East Pakistan.

I am particularly upset about the outcome of the discussions on this particular point because I had thought that I had made my concern about the budgetary situation perfectly clear to John Gunter and Ishaq before I left Copenhagen. Moreover, it was quite obvious in our meeting with the heads of delegations in Paris that the Consortium shared this concern. It is impossible to guess how they would react if they had to be told that the additional resources accruing to the Government from their support - whether through additional commodity assistance or through debt relief - would merely compensate for the negative impact of the reform on the budget and thus enable the Government only to keep the development program at the present unsatisfactory level, particularly as far as East Pakistan is concerned. However, I am afraid that we would find it very difficult to get anywhere near the $175 million that we have been talking about. Manfred made this quite clear to both John Gunter and the Pakistani negotiators when he met with them in Copenhagen after the Paris meeting.

The second major weakness is that, as the proposal stands at present, it would widen rather than narrow the difference in effective cost of imports of finished capital goods and raw materials. According to our calculations, the details of which are shown in Attachment I, the difference would increase from Rs. 1.92 to Rs. 4.30 per U.S. dollar. Considering that underpricing of investment and the large spread between the cost of capital goods and raw materials was perhaps the largest source of inefficiency in the allocation of resources in the exchange and import regime as it developed during the second half of the 1960's, I just cannot see how one can contemplate undertaking a major reform without tackling these problems.

Undoubtedly, an increase in the effective cost of imported capital goods above the level now contemplated would raise political problems. In particular, East Pakistan would certainly argue that such a move is essentially designed to frustrate their plans just at the time when they had thought they had finally won the battle for a larger share in the country's total resources. I believe we all sympathize with this concern, but I believe it also needs to be said that this problem is essentially one of transfers and of budgetary allocations. To try to deal with it through the exchange rate structure is not only highly inefficient, but also highly undesirable because of the disadvantageous position in which domestic manufacturers of capital goods would be placed as a consequence.

I should have thought that as far as East Pakistan is concerned at whatever level one puts the effective cost of imported capital goods it is essentially an accounting price: most investment is undertaken by the public sector, and additional outlays arising out of higher duties would be matched by additional receipts; surely some way could be found around the difficulty that outlays would have to be made by the Province while the revenue would accrue to the Centre. A net shortfall in resources would only occur to the extent that, as a result of domestic manufacturers being placed in a better position to compete, capital goods are procured domestically rather than abroad. However, I would be quite surprised if this came to more than US$30 to $40 million a year for East Pakistan. This would be quite a substantial amount for domestic manufacturers, but the net budgetary impact should surely be manageable.

So, unless you have strong objections to the positions I have outlined, here is what I want you to do: I want you to call on the Finance Minister - who I hope will ask Ishaq and others with knowledge on the subject to attend - and explain to him that we are deeply disturbed about the way the reform seems to be shaping up in some highly important areas. Referring to Manfred's meeting with the negotiators in Copenhagen, you should point out that if what I have said above, particularly on the budgetary front, is a reasonably accurate description of the implications of the reform, we would enter into our discussions with the Consortium about supporting assistance for the reform with a very much weaker case than we thought we would be able to present and than we would regard as essential for getting anywhere near the amount for which we have asked.

Ideally, what we would want them to do is through a combination of a reduction in subsidies below the level now contemplated and additional revenue measures, to keep the public development program in real terms intact at the present level, say, Rs. 660 crores. I expect the Consortium would be prepared to go along with something less than this ideal situation but it is essential that they be assured that the Government is prepared to take such fiscal measures as will be necessary to ensure that the major part of their support will be used for increasing the development program beyond Rs. 660 crores.

I personally do not feel quite as strongly about the cost of capital goods and its implications for domestic suppliers, although I think the present proposal is foolish. However, it is also obvious that our argument vis-a-vis the Consortium that what is proposed amounts to a major reform and therefore deserves their fullest support will be weakened considerably if the reform in fact fails to resolve satisfactorily this issue of which everybody in the Consortium is only too well aware because we have hit it so hard in successive economic reports. Moreover, I know that the United States response is likely to be influenced by Government action in this respect. Here again it is difficult to be precise about what would be a satisfactory resolution, but I would be prepared to defend an average effective rate of Rs. 10 to the U.S. dollar, including duties, for capital goods, perhaps somewhat, but not much, less, for East Pakistan.

For your general information, I am also enclosing copies of the paper we distributed to the Consortium in Paris and of the minutes of that meeting.

Manfred and I have tentatively planned to leave Washington on October 21 for further discussions in London, Bonn, Paris and Rome on October 22 and 23. It would obviously be helpful if we could have some initial reaction from you before we leave.

One last thing: we promised to let the Government know when we would have our next round of discussions with individual members of the Consortium. Would you, therefore, please convey to them our plans as indicated above. In addition, we will meet with the Canadians and the U.S. either shortly before or after our trip to Europe. You should also tell them that in the event they are not prepared to strengthen substantially the present draft agreement along the lines indicated in this letter, we will almost certainly have to have another meeting of heads of delegations at which we would want the Pakistan Government to be represented, both to explain their position and to hear for themselves the reactions from the Consortium.

Yours sincerely,

I.P.M. Cargill
Director
South Asia Department

Attachments

MGBlobel:os
IBRD

FORM No. 89
(2.66)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

INTERNATIONAL FINANCE CORPORATION

7/17

File

Mrs. Rosso

ROUTING SLIP

Date: July 17, 1970

OFFICE OF THE PRESIDENT

Name	Room No.
Mr. McNamara	

	To Handle		Note and File
	Appropriate Disposition		Note and Return
	Approval		Prepare Reply
	Comment		Per Our Conversation
	Full Report		Recommendation
	Information		Signature
	Initial		Send On

Remarks

Please find attached a letter delivered to me today by the Ceylonese Ambassador, which he said should be regarded as replacing the letter of July 6th, also attached, which had been sent by mistake (a "secretarial" error).

I would like to talk to you about this.

John

From

J. Burke Knapp

The follow[illegible] is the text of the cable mess[illegible] received from External Affairs, Colombo, to be handed over to Mr. McNamara by The Ambassador of Ceylon.

488/6/11

IN REPLY, PLEASE
QUOTE REFERENCE NO.
PHONE: 202 HU. 3-4025

Embassy of Ceylon
2148 WYOMING AVENUE, N. W.
WASHINGTON, D. C. 20008

S E C R E T

16 July 1970

Mr. Robert S. McNamara
President
International Bank for Reconstruction and Development
1818 H. Street, N.W.
Washington, D.C. 20433.

Dear Mr. President,

As you know, the following loan and development credit agreements have been signed on behalf of the Government of Ceylon on the dates, and in respect of the projects set out below:

Project	Credit/Loan No.	Signed	Effective
Mahaveli Ganga Development	Credit No.174 Loan No.653	30 Jan 70	Not yet effective
Fourth Power	Loan No.636	28 Jul 69	19 Jan 70
Highway	Credit No.133 Loan No.569	12 Nov 68	12 Feb 69

You will appreciate that the new Government has inherited the legacy of an acutely adverse financial and balance of payments position. Consequently the Government has felt compelled to review its priorities in the field of development, taking into account the desirability of utilizing and developing to the fullest extent Ceylon's own resources in manpower and technology in an ...*.... effort to reduce the need for external borrowing.

In the course of this review the Government may need to take certain decisions which could have a direct bearing on the agreements relating to the projects mentioned above. I would like to seek your co-operation, and that of your staff in implementing those decisions in a manner satisfactory both to your Institutions and to my Government.

Accordingly, ... page 2.

* mutilation

Accordingly, I would like to suggest that a team of your officers meet with my Government representatives as soon as possible in order to discuss and resolve the many issues that must necessarily arise in connection with this review. I plan to attend the annual meetings of the Bank and Fund in September, and should there be any major issues then remaining unresolved I would be glad to discuss them with you at that time.

The Government of Ceylon appreciates the willingness of the Association and the Bank to undertake the financing of these projects, and the work of their staff in the preparation of the projects. We shall look forward to continuing cordial relations that have always existed between your group of Institutions and Ceylon, and would welcome their advice and assistance in dealing with the problems that lie ahead of us.

Yours sincerely,

N. M. Perera

Minister of Finance,
Governor for Ceylon.

FORM No. 89
(2.66)

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT
ASSOCIATION

INTERNATIONAL FINANCE
CORPORATION

ROUTING SLIP	Date July 13, 1970

OFFICE OF THE PRESIDENT

Name	Room No.
1. Mr. McNamara to see	
2. Mr. Cargill to handle	

President has seen

	To Handle		Note and File
	Appropriate Disposition		Note and Return
	Approval		Prepare Reply
	Comment		Per Our Conversation
	Full Report		Recommendation
	Information		Signature
	Initial		Send On

Remarks

Copies have gone to Messrs. Knapp,

Broches/Aldewereld.

L.E. Christoffersen

From

IN REPLY, PLEASE
QUOTE REFERENCE NO.
PHONE: 202 HU. 3-4025

JUL 13 REC'D

Embassy of Ceylon
2148 WYOMING AVENUE, N. W.
WASHINGTON, D. C. 20008

13 July 1970

Mr. Robert S. McNamara
President
International Bank for Reconstruction and Development
International Development Association
1818 H. Street, N.W.
Washington, D.C.

Dear Mr. McNamara,

I have been requested by the Government of Ceylon to forward to you the enclosed letter from the Honorable Minister of Finance of Ceylon, Dr. N. M. Perera.

Yours sincerely,

O. Weerasinghe
Ambassador of Ceylon
to the U.S.A.

Enclosure:

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ලංකාව
OFFICE OF THE FINANCE MINISTER
CEYLON

6th July, 1970.
7

Dear Mr. President,

As you know, the following Loan and Development Credit Agreements have been signed on behalf of the Government of Ceylon on the dates, and in respect of the projects set out below : -

Project	Credit/Loan No.	Signed	Effective
Mahaweli Ganga Development	Credit No.174 Loan No.653	30. 1. 70	Not yet effective
Fourth Power	Loan No.636	28. 7. 69	19.1.70
Highway	Credit No.133 Loan No.569	12.11. 68	12.2.69

You will appreciate that the new Government which pledged itself during the General Elections campaign to review these agreements, one of which had been placed before Parliament on the very eve of dissolution, was in duty bound to conduct its pledged review in the new political climate and in relation to the outlook and expectations of a resurgent people. Further the new Government inheriting the legacy of an acutely adverse financial and balance of payments situation and faced with the need to minimise external

Cntd...P/2.

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ලංකාව
OFFICE OF THE FINANCE MINISTER
CEYLON

borrowing, was compelled to review its priorities in the field of development. The Government had also to take into account the desirability of utilising and developing to the fullest extent Ceylon's own resources in manpower and technology in the execution of these projects.

In the circumstances, we have, after very careful consideration come to certain decisions which have a direct bearing on the agreements relating to the projects above-mentioned.

With regard to the Mahaweli Ganga Development Project, the Development Credit and Loan Agreements for which are not yet effective, it has been decided not to take the remaining action required to bring those Agreements into effect by the new terminal date for effectiveness, (aug.) July 31, 1970. It is our understanding that in the absence of such action, Section 10.04 of the General Conditions Applicable to Development Credit Agreements and Section 11.04 of the General Conditions Applicable to Loan Agreements would operate to terminate the Development Credit and Loan Agreements for this Project, and all obligations of the parties thereunder.

Cntd...P/3.

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OFFICE OF THE FINANCE MINISTER
CEYLON

As to the Highway Project, it has been decided to cancel the amount of the Development Credit not withdrawn from the Credit Account and the amount of the Loan not withdrawn from the Loan Account, in accordance with Section 5.01 of the Development Credit Regulations No.1 of the Association dated June 1,1961, as amended February 9, 1967, and Section 5.01 of Loan Regulations No.3 of the Bank dated February 15, 1961, as amended February 9,1967. Telegrams effecting cancellation were dispatched to the Association and the Bank on June,1970. I would appreciate it if those communications were accepted as notice to the Bank as required pursuant to the Regulations.

Tel. not received.

With regard to the Fourth Power Project, it is proposed to seek the Bank's agreement to certain modifications of the Project and to negotiate corresponding changes in the Loan Documents for the Project.

I would like to stress that the Government of Ceylon have not decided lightly upon the measures outlined above. On the contrary, this action is being taken on the recommendation of three Committees of experts appointed by the Minister of Irrigation, Power and Highways, who have just

Cntd...P/4.

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OFFICE OF THE FINANCE MINISTER
CEYLON

completed a detailed study of these projects. The Government is in full agreement with this recommendation.

I would like to seek your co-operation, and that of your staff in implementing these measures in a manner satisfactory both to your institutions and to my Government. Accordingly, I would like to suggest that a team of your officers meet with my Government's representatives as soon as possible in Colombo in order to work out the financial and other implications of these measures. I plan to attend the Annual Meetings of the Bank and the Fund in September, and should there be any major issues then remaining unresolved I would be glad to discuss them with you at that time.

The Government of Ceylon appreciate the willingness of the Association and the Bank to undertake the financing of these Projects, and the work of their staff in the preparation of the Projects. We shall look forward to continuing the cordial relations that have always existed between your group of institutions and

Cntd...P/5.

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ලංකාව
OFFICE OF THE FINANCE MINISTER
CEYLON

Ceylon,and would welcome their advice and assistance in resolving the problems that lie ahead of us.

Yours sincerely,

N.M. Perera

(N.M. Perera),
MINISTER OF FINANCE,
GOVERNOR FOR CEYLON.

Mr. Robert S. MacNamara,
President,
International Bank for Reconstruction and Development,
International Development Association,
1818 H Street, N.W.,
Washington D.C. 20443,
U. S. A.

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

488/6/10

OFFICE MEMORANDUM

DRAFT

TO: Mr. I.P.M. Cargill

N/C

DATE: May 8, 1970

FROM: William M. Gilmartin

File

SUBJECT: Do Capital Goods Imports Signify Bank-type Projects

At the recent meeting of the Executive Directors on the latest industrial import credit, the Director for France noted that Indian capital goods imports in 1969 were about $700 million. This suggested to him that a capital goods import level this large should offer scope for ~~reading~~ meeting Bank/IDA operational objectives in India on the basis of the capital goods import components of particular projects. This is a non-sequitur and, I believe, wrong even though there are no detailed studies of the nature of the uses to which capital goods imports are put. There are, however, reasons for questioning the relevance of the $700 million to the issue of conventional financing in India.

The first and probably obvious point is that $700 million, while perhaps a large capital goods import figure for most developing countries, is relatively small in India. It represents less than 15% of the total public and private gross investment. Furthermore, it should be noted that the $700 million includes an unknown but probably significant amount of military equipment. Hence this figure of something less than $700 million is hardly impressive when compared with Indian production of comparable categories of capital goods which is over three times as large, or when spread out over a range of total investments adding to about $5 billion.

It is known that the spread is fairly thin from the standpoint of particular projects. Concentration of imported capital equipment is large only in the case of fertilizer and other petro-chemicals; for certain kinds of specialized operations such as heavy dredging and off-shore oil explorations; and for airplanes, ships and some types of heavy earth moving and mining equipment. Otherwise the capital goods imports (non military) are mainly for replacements, balancing equipment, small proportions of special and sophisticated equipment supplementary to Indian-made equipment in a wide range of public and private investment activities.

This pattern is reflected in the Indian Government's statement on project aid requirements presented to the 1969 Consortium meeting. The list of so-called project requirements added to $658 million. These represented proposals for commitments to be disbursed over an unspecified period extending for more than one year. Within this total, the only sizeable equipment items for particular projects in the usual Bank sense were for 10 fertilizer projects of various sizes, a few downstream units linked to a Naptha Cracker Plant, and a PVC, and a Caprolactam project. These in total required about $270 million of imported equipment. Other of the larger single items were for civil airplanes and airport installations, dredging equipment and semi-program financing of imports for the railway and telecommunications investment programs. These items accounted for about 75% of the total. The remainder consisted of miscellaneous capital equipment for a wide variety of firms and purposes -- all small or otherwise not in accordance with Bank project patterns, e.g. $60 million of imported equipment for about 40 different manufacturing firms, $10 million of equipment for a large number of major and minor irrigation works, $20 million of equipment for several different public and private mining projects, etc.

All this suggests the spread and variety of purposes to which capital goods imports are put and the doubtful nature of the assumption that capital goods imports in India necessarily means Bank-type project possibilities.

488/6/9

RECORD OF CONVERSATION April 20, 1970

SUBJECT: IDA Third Replenishment - Germany

Dr. Hanemann called on Mr. McNamara this afternoon at the latter's request. I was also present.

2. Mr. McNamara said that he had felt that it might be useful for Dr. Hanemann to know of one or two developments which had taken place since the London Meeting of the Deputies.

3. We told Dr. Hanemann that the Japanese Government had stated that they would be willing to agree to a figure of $1 billion a year for the Third Replenishment if other governments would do so also. They had also implied that in certain circumstances they might accept some increase in their share of the contributions. In addition, we had been told that two or three other governments were reconsidering their position and might be ready to support, in Vienna, a high figure for the Third Replenishment.

4. Mr. McNamara said that all that had happened since last December confirmed his feeling at that time that the role of Germany would be crucial. Had Dr. Hanemann any further news of the German position?

5. Dr. Hanemann said that the German Government had not yet taken a final decision but he believed that they would do so this week. Dr. Schiller still thought, as he had told Mr. McNamara in December, that replenishment at the level of $1 billion was not within reach. When Mr. Moeller had said recently in Washington that Germany would not stand in the way of an agreement at a level acceptable to the U.S. Government, he was to be understood to have meant that some compromise would be found between the two extremes of $400 million and $1 billion. He (Dr. Hanemann) did not interpret this as meaning that the German Government would necessarily fall into line with the U.S. Government. The position was, therefore, still open. Dr. Hanemann then referred to the position of the French Government. This, he said, had varied but if they made no advance on a figure of $500 million, the German Government would certainly go higher. He himself had told Mr. Plescoff that the French Government would probably find themselves isolated even if they went as high as $600 million. He was aware that the French Government considered that they were entitled to some reduction in their share of contributions.

6. Mr. McNamara said that while he did not feel himself at liberty to disclose what he had learned of the French position in Paris, he could say that it was clear that in certain circumstances they would accept a figure for the Third Replenishment substantially higher than the figure of $500 million which they had first mentioned. This, no doubt, might be coupled with some request for reconsideration of their share. Other governments might feel that there was some ground for this request and it might prove possible to find an answer to this question which would enable the French to accept a high figure.

7. Dr. Hanemann expressed great interest in what Mr. McNamara had told him and asked whether he could pass it on to his government.

8. Mr. McNamara replied that in the light of this conversation he felt that it might be desirable for him to send a personal message to Dr. Schiller, sending a copy of it at the same time to Herr Moeller. He would ask Dr. Hanemann to cable these messages and he would, of course, be free to add any comments of his own that he wished.

D. H. F. Rickett

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488/6/8

March 10, 1970

Mr. Robert S. McNamara
President
International Bank for Reconstruction
and Development
Washington, D.C. 20433

Dear Bob,

This is a short postscript to the record of our recent discussions which I sent you with my letter of March 6th. John Adler can supplement it in detail.

The main discussion on the amount of the Third Replenishment took place during the morning session yesterday. The Canadian Delegation asked me to call on them on the previous evening and showed some hesitation about giving outright support to a figure of $1 billion. They feared that this might have the effect of driving the Common Market countries into a corner. I said that the French had already taken up a very restrictive position at the Paris meeting and that unless we had a further discussion we should lose the benefit of declarations of support from those countries favouring a high figure. If we were to have such a discussion, it would surely arouse doubts and speculations if the Canadians did not maintain the attitude which they had adopted in Paris. Hudon finally agreed with this view. I believe that Willian Clark had spoken in the same sense to Maurice Strong.

I also saw Petty before the meeting and he confirmed that the United States would speak in favour of $1 billion though, since the President has not yet made his promised statement on the Peterson Report, he (Petty) would say that "the U.S. Governor (i.e. the Secretary of the Treasury) intended to recommend to the President that the United States support a figure of $1 billion. I suggested that it would have a good effect if he could also add that the United States would not ask for balance of payments safeguards since I knew that Geoffrey Wilson would raise this point. Petty did not, however, feel able to go so far at the present stage. They apparently think this point may have some bargaining advantage with the Common Market countries later.

Geoffrey Wilson opened the discussion and spoke on the lines which he had indicated to me before the meeting. He was followed by Grooters who spoke quite unequivocally in favour of $1 billion. This was extremely satisfactory and must, no doubt, have been a surprise to some of his Common Market partners (the Belgians and Italians did not expect him to do so). The figure of $1 billion was then firmly supported by Sweden. The Canadians also spoke in favour of it though they added the usual formula that this was "subject to the provision of the necessary funds by Parliament". Petty then spoke for the

United States on the lines he had indicated and was followed by the Norwegian, the Dane, and the Finn. There were thus, as we had hoped, eight countries representing 65% of total contributions who spoke in favour of a figure of $1 billion.

The remaining countries voiced doubts in varying degree. Only the French, however, and John Stone for Australia specifically supported the figure of $500 million. Rene Larre repeated the arguments which he had used in Paris about the level of French aid and the importance of the bilateral element in their program. He also raised the question of the Bank's capital and, at this point, I made a statement on the lines approved by you. There was, however, no reference to the question of supplementary finance. The German, the Italian, and the Belgian all said that their governments had not yet taken a final decision. The German and the Belgian added, however, that they doubted whether a figure of $1 billion would be attainable, and implied that they would support a figure closer to the lower end of the range. Suzuki, for Japan, also doubted whether a figure as high as $1 billion was practicable. Austria and Luxembourg also expressed doubts about the high figure. The Austrian representative said that he did not know what the views of the new government would be but that the Treasury felt that the increase in IDA contributions should take into account the decline in the purchasing power of money and the expected increase in public revenues but should not go further than that. He therefore associated himself with the views expressed by the French and German delegates.

The discussion therefore had the effect, to some extent, of bringing out more clearly the opposing points of view but everyone was well aware already that this difference existed. What seemed to us encouraging was that the supporters of the high figure spoke with greater precision and firmness than the supporters of the low figure who clearly did not wish to commit their governments on the figure which they would finally be willing to adopt. They were clear only that $1 billion was a good deal too high.

It was also noticeable that Rene Larre included in his speech a reference to the possibility that France might either take no part in the Third Replenishment or would do so at some lower level. No representative held out any hope at this stage that his government would raise their percentage contribution except the Norwegian who said that they would go up from 0.9% to 1% provided that the total were $1 billion. In conversation with me at luncheon today, Klackenberg also hinted that the Swedes might be willing to increase their percentage share, perhaps on a rising scale, but questioned whether it was good negotiating tactics to say this openly at the present stage. This would only encourage other countries to ask for a reduction. I suggested that when they were ready, the Swedish Government should let us know privately what their intentions were.

I will not trouble you with the details of the discussion on the adjustment of voting rights and on the possibility of changes in the procedure for the deposit and encashment of notes. Voting rights, in particular, will have to be discussed again at the next meeting in the light of the views of the Part II countries and in the light of a further paper which we have promised on the amendment to the Articles.

You may like to know that John Petty was leaving for Paris this evening and is going on to Bonn tomorrow evening where he will see Hankel. He has certain ideas which might help to resolve our burden sharing difficulties which he did not wish to elaborate further at this stage until he has sounded out some of the important parties.

In saying goodbye after the luncheon today, de Larosiere remarked that Rene Larre had been very pleased with the meeting "and that the French Government would explore the whole question thoroughly with you in your discussions next week". Whether this is more than mere politesse, I cannot say. meaning?

The German attitude was also rather more forthcoming than I had expected it to be. Adler and Karasz both talked to Koinzer and he said that he would submit the whole matter to his government. He said that the real difficulty in Bonn lay in the Ministry of Finance and that the Minister, in particular, was adamant that $600 million was as high as they should go. This seems to us to underline the importance of a visit by you in April to Bonn.

Petty also thought that the U.S. Government and you, yourself, might talk to Brandt when he comes to Washington later this month.

We agreed,in conclusion, to fix provisionally a further meeting of the Deputies in Vienna on the 27th and 28th April at which there will be a further discussion of voting rights, including an amendment to the Articles. This will also give an opportunity of taking stock of the position regarding the amount and the sharing of the burden. It was noticeable that very little was said on this latter topic during the present meeting.

All things considered, I think the meeting went off as well as we would have hoped or expected but there is obviously a lot to be done before a satisfactory result can be achieved.

With all good wishes for your Paris visit,

Yours ever

D. H. F. Rickett
Vice President

David.

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488/6/7

March 6, 1970

Dear Bob,

I enclose a brief summary of the talks which John Adler and I have had with the representatives of various governments.

It was somewhat disappointing to find in Rome that Colombo and Carli took the view that they were committed to their Common Market partners to support a figure of no more than $500 million. We, therefore, were obliged to concentrate on the rather limited objective of getting them to hold their hand in order to give you time to work on the French and the Germans. We also adopted a similar line in speaking to the Belgians.

On the other hand, it is extremely encouraging that the Netherlands is taking a robust line and will stick to their figure of $1 billion in spite of what was said in Paris last week.

The British position also seems to have developed in the right direction and, according to Geoffrey Wilson, the Prime Minister spoke very effectively on the subject of IDA in his talks with Chancellor Brandt.

John Adler will be able to give you a further and fuller report when he gets to Washington.

Yours ever
Denis

D. H. F. Rickett

Mr. Robert S. McNamara
President
International Bank for Reconstruction
and Development
Washington, D. C. 20433

I.D.A. THIRD REPLENISHMENT

LONDON MEETING - MARCH 9TH AND 10TH

SUMMARY OF PREPARATORY TALKS

Italy

Mr. Adler and I visited Rome from March 2nd to 5th. During our visit we entertained Governor Carli and Dr. Ossola to dinner and also had a meeting with the Governor at the Banca d'Italia. We also called on Minister Colombo at the Treasury. The Italian Executive Director, Mr. Rota, was present on all these occasions.

In discussion with Governor Carli he made the following points:-

(i) The present political situation in Italy was extremely difficult and this was having repercussions on the economic situation. The lira was fundamentally strong and it was, in fact, desirable that the Italian current account surplus should be reduced since it was not appropriate for a country, at the stage of development of Italy, to transfer real resources abroad on such a large scale. It went without saying, however, that the present rate of capital outflow, which was more than double the current account surplus, should be brought into line with the current account in order to avoid further losses of reserves;

(ii) Because of the present political and economic situation this was a bad moment for the Italian Government to assume fresh commitments towards IDA on an increased scale. He recognized that the real economic effect of these commitments would not be felt until the mid-70's, nor did he regard the difference between an Italian contribution at the rate of $20 million a year (corresponding to a total replenishment of $500 million) and one of $40 million a year (corresponding to a total of $1 billion) as significant in economic terms. The difficulty was political and presentational;

(iii) The economic situation would probably improve over the next few months. The recent measures centralizing in the Banca d'Italia transactions relating to the repatriation of Italian bank notes had already significantly checked the illicit outflow of capital. It was true that large wage increases had been granted but this was the case in other countries also and he did not expect the Italian competitive position to be seriously affected;

(iv) The Italian Government would consider itself bound by the understanding reached during the discussion between the Common Market Finance Ministers in Paris on February 24th and could not, therefore, at this stage, support a figure for the total of the Third Replenishment at a level higher than $500 million;

(v) He agreed that there was no necessity for the Italian representative to mention any specific figure at the meeting in London. I said that I would certainly not press him to do so. What we should like would be to have more time for bilateral discussions with Common Market countries before they took a firm position.

We went over much the same ground with Signor Colombo. He said that the discussion in Paris had been brief but that, nevertheless, for the present he regarded himself as committed to his Common Market partners. The matter had been raised by the Netherlands Finance Minister who had spoken strongly in favour of a high level of replenishment ($1 billion). This had been opposed by the French and German Finance Ministers who had taken a much more conservative view. Minister Schiller had proposed a figure of $500 million. He, himself, and the Belgian Finance Minister had taken a somewhat more liberal view. The figure of $500 million, which had been adopted as the common position, was no doubt negotiable but a further discussion would have to take place before it could be increased.

I asked Signor Colombo whether he could agree that his representative need not mention any specific figure in London but should either not speak or should take a non-commital line. I told him, as I had told Governor Carli, that we should like to have more time for bilateral discussions with Common Market countries and hoped that in the meantime their position would not be fixed too soon. He said that he saw no difficulty in agreeing to this.

The Netherlands

Mr. Grooters called me on the telephone this morning as he had promised to do before leaving Washington. His Minister had now authorized him to support a figure of $1 billion at the meeting next week. Prof. Witteveen did not consider himself bound to adopt the figure of $500 million proposed in Paris. He considered that he had fulfilled his obligation to consult with his Common Market partners and that he therefore now had freedom of action.

I told Mr. Grooters that we were extremely pleased to hear this. It was agreed that he would speak early in the meeting but preferably after two or three other countries had spoken in favour of a figure of $1 billion.

The United Kingdom

I also spoke this morning to Sir Geoffrey Wilson who told me that he was now authorized to speak on Monday in favour of a figure of "up to $1 billion". This would be subject to conditions:

(i) That no country should ask for balance of payments safeguards;

(ii) That the U.K. percentage share should not be increased.

In addition, he would state for the record two desiderata:-

(i) That the share of IDA resources going to India should not be reduced below the present level of 40%;

(ii) That the Association should adopt techniques of lending which would lead to a sufficiently rapid disbursement of IDA credits.

He agreed that he would not expect me to add anything at the meeting to what had already been said on this subject in the discussion between Mr. McNamara and Mrs. Hart in Washington. Sir Geoffrey expressly asked that he should speak first in the discussion on the amount of the replenishment.

Sir Geoffrey also told me that the level of the Third Replenishment had been mentioned by the Prime Minister to Herr Brandt and that the Prime Minister had spoken strongly in favour of a high figure. Herr Brandt had suggested a figure of $600 million. The Prime Minister had said that this seemed to be inadequate given that the present rate of commitment was $600 million. (He appears to have ignored the effect of the transfer of Bank profits.)

Belgium

I tried to speak to the Belgian Finance Minister, Baron Snoy d'Oppuers, but he was engaged in a meeting of the Council of Ministers. I therefore spoke to M. Marcel d'Haeze. I said that there was a substantial body of opinion in favour of a figure of $1 billion and hoped that, if the Belgian representative could not support this figure, he would not mention a figure at all. M. D'Haeze said that the Belgian Government could accept a figure of $600 million. I said that we should prefer that he should mention no figure at all. (Mr. Adler and I subsequently agreed that while $600 million is better than $500 million, it falls a long way short of $1 billion.)

Sweden

I spoke this afternoon to Mr. Klackenberg who confirmed that at the meeting on Monday he would support a figure of $1 billion. He would prefer not to give, at this stage, a figure for the absolute amount of the Swedish contribution. All he could say at present was that it would not be less than the Swedish share in the Second Replenishment, i.e. a little over 2% (this excludes the

Swedish supplementary and special supplementary contributions). Mr. Klackenberg also said that he thought that in the Third Replenishment the Swedish Government might wish to revert to the practice they had followed in the First Replenishment of paying their contribution in the form of non-interest bearing notes rather than in cash as they had done for the Second Replenishment.

Mr. Klackenberg added that the question of voting rights had now become a matter of some political interest in Sweden having been raised in the Riksdag. I said that I hoped that he would give strong support to the proposal which I had made that Part II country subscriptions should be payable wholly in local currency and should not exceed \$50 million approximately in total. Otherwise, I thought it would be very difficult to reach agreement on a practicable scheme. Mr. Klackenberg said that he would certainly support us strongly on this point.

We also had some discussion on the question whether contributions should be paid in three equal amounts or on a rising scale. I said that what mattered to IDA was the aggregate amount of the replenishment since this determined the commitment authority which we had. It was also necessary that we should encash contributions at a rate sufficient to cover disbursements but this, as he would have seen from the paper we had circulated, would be spread over a considerable number of years. The choice between a level and a rising scale of contributions would, no doubt, have political and presentational significance and would, of course, have an economic effect in the case of countries which paid cash. I understood from Mr. Klackenberg that for budgetary and presentational reasons, the Swedish Government might, on this occasion, prefer a rising scale of contributions.

The result of these preliminary consultations seems to be that there will be eight countries accounting for roughly two-thirds of total contributions who will support a figure of the order of \$1 billion (this includes the United States and Canada with whose representatives I shall be making contact tomorrow and Monday morning). Outright opposition and advocacy of a figure of \$500 million will, if our efforts have been successful, be confined to two countries (France and Germany) accounting for 18.3% of contributions. It is clear also that the figure of \$500 million, mentioned in the Common Market discussions, is a negotiating figure. The Belgians (and probably the Italians) would have been prepared to support \$600 million which is also the figure mentioned by Chancellor Brandt to Prime Minister Wilson.

D. H. F. Rickett
March 6, 1970