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

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: December 19, 1969

FROM: Irving S. Friedman

DEC 22 1969 10:30 (Returned)

SUBJECT: Article for Briannica Book of the Year

For some years I have been doing the article on Economic Development for the Britannica Book of the Year for the Encyclopaedia Britannica.

This year they asked me to do an additional article of a broader character. You may find it interesting to glance at this article, although it will say nothing new to you, particularly in light of the views you expressed the other day.

ISF

President has seen

December 16, 1969

THE CRISIS IN INTERNATIONAL DEVELOPMENT

The years since the end of the Second World War have been notable for the growth of an almost universal commitment to promote the economic and social development of the poorer countries. Never before have so many thought so deeply and striven so hard to organize, in concert, a constructive effort to meet one of the greatest challenges in history: helping 2,000 million people in over 100 countries to achieve the economic and social transformation so necessary for their continued survival as viable nations.

Until the early decades of the twentieth century, such international cooperation as there was between poor societies and rich arose mainly out of political and trading relationships. The flow of capital, and of other factors of production, which took place within the framework of those relationships was by no means negligible. But the effort today -- in nature, size and intent -- is very different from what it was then.

The change has been guided by three main concepts. The first is political: the recognition that a situation where two-thirds of the people live in deep poverty while one-third enjoy varying degrees of affluence cannot be conducive to the long-term peace and stability of the world. The second is humanitarian: that such a situation is basically unjust, and therefore offensive to the human conscience. Thirdly, there is an awareness that the well-being of all is best promoted not by the isolated affluence of the few but by the shared progress of the many. The validity of these concepts has been increasingly accepted within national frontiers and the post war efforts at international economic cooperation derive sustenance from the same kind of thinking.

It is interesting to examine the results of these efforts so far. They have, on the whole, been fairly encouraging. It is true that the progress of the poorer countries has been neither spectacular nor uniform. Some have made impressive gains; others have lagged behind badly. But, taken as a group, it is no inconsiderable achievement that their economic growth during the 1960's has averaged almost 5% a year -- thus approximating the target set by the United Nations nine years ago when it designated the period as the Decade of Development. Not only is this rate of growth higher than in the 1950's, when it averaged about 4.6%, it is also substantially higher than that achieved by the developed countries in the early stages of their development.

The greatest advance has been in industry. Since 1948 their industrial production has risen, on average, by 7% annually, and the rise has been accompanied by a considerable diversification of industrial activity. Their agricultural production has also increased, although less adequately (by about 3% annually). Not only has the proportion of the population employed in agriculture been steadily falling, but in many countries the modernization of agricultural enterprise through the use of recent technological advances is making impressive progress. The improvements in productive capacity have facilitated an expansion of trade. Between 1960 and 1968 the less developed countries have increased their annual exports from about $28 billion to $44 billion while their imports have risen from a little over $30 billion to $45.5 billion.

Of even greater significance for the future is the fact that, over the years, the developing countries have greatly increased their capacity to absorb new investments productively and efficiently. The infrastructure facilities that are essential to economic development -- such as roads, railways, electric power plants -- have been greatly expanded in many countries. There have been improvements in education, in health services -- improvements that are never quite reflected over the short-term in national income statistics.

In this connection, a point which bears emphasis is that about 85% of the investment which has made the growth possible has been financed by the less developed countries from their own resources. These savings have been mobilized from people who generally live not much above the subsistence level, and whose capacity for saving is therefore extremely limited. The remaining 15% of total investment has been financed from abroad in the form of public loans or grants or private investment. But, although proportionally small, it has represented a vital contribution for, without it, the recipients would not have been able to import the machinery, equipment and other essential ingredients of development.

In absolute terms, also, the contribution has been a substantial one. Between 1961 and 1968, the net flow of official resources from 16 developed countries to less developed countries and multilateral institutions totalled about $51 billion. In 1968, it was $7 billion. In addition, during the same period, there was a private flow totalling about $30 billion reaching a level of close to $6 billion in 1968.

Apart from providing capital, the developed countries have supported the growth of the less developed through technical assistance programs, both bilateral and multilateral, aimed at alleviating the shortage of technical, scientific and managerial skills that are often as serious an obstacle to economic progress as the shortage of capital itself. The developed countries have also made some, although by no means adequate, efforts to expand their trade with the less developed. This has been done by the general lowering of barriers on products of interest to developing countries or by negotiating special arrangements such as those of France with her former African colonies.

Although the development effort has scored considerable successes, the problems that remain are formidable. In the developing countries, too many of the fruits of economic growth continue to be neutralized by growth in population which has been increasing at an annual rate of 2.5% on the average. While better medical and sanitation facilities have reduced death rates, birth rates remain high. The rise in population not only keeps down living standards when economies are registering significant rates of growth in overall output but it has an impact on the overall growth rates themselves. It enhances the difficulties in obtaining more domestic savings and causes increased demands for public capital investments, e.g. hospitals, school buildings, etc. It also has specially important implications for dealing effectively with the already existing problems of large scale unemployment and illiteracy.

Unemployment is endemic in the poorer countries, averaging 20% and frequently higher. It is aggravated by crowding in cities, which are little more than huge collections of human beings living without adequate water, sewerage, housing, schools, transportation, medical facilities, etc.

There have also been weaknesses in following satisfactory economic policies in many developing countries. In the manufacturing sector, for example, the policy of increasing domestic production of manufactured goods to substitute for goods hitherto imported has frequently created serious problems. The foreign exchange saving of import substituting industries has proved to be much less than was expected because of the continuing need for imports of equipment and intermediate goods. Because almost all the less developed countries have small markets, in the economic sense, substitution for imports has led either to production in small plants of less than optimum size or to optimum-sized plants producing below capacity. In both cases, the result has been high-cost production behind high tariff walls. Not only has it made the balance of payments problems worse; it has negated the dynamic element of growth which could come best from an internationally competitive export sector.

Until quite recently, it was in the agricultural sector that growth experience had been most disappointing. Agricultural production barely kept pace with population growth, and in many areas it even fell behind. Per capita food production in particular rose very slowly during the sixties, and in some cases not at all. Fortunately, however, thanks to a change in government policies, increasing use of fertilizers, and a technological breakthrough in high-yield varieties of wheat and rice, the situation has changed dramatically in the last two years. A good part of the developing world is now experiencing a major change in the outlook for food production, widely characterized as the Green Revolution. It is too early to say how deep and how lasting the impact of this revolution will be. It will largely depend on whether the developing countries continue to show the determination, and intensify their efforts, to solve their agricultural problems including those which arise out of the very successes of the technological breakthrough.

Increasing the rate of national savings out of additional income remains an especially important need of public policy in the less developed countries. These savings are the counterpart to the real resources which are needed for investment. Increasing savings present tremendous problems, for the poorer a country, the more difficult it is to divert current income away from consumption. There are also many institutional and sociological difficulties in mobilizing savings. In too many countries, social privilege takes the form of an inequitable sharing of the burden of taxation. On the other hand, too much taxation of the most productive and enterprising firms and individuals may dampen the development process. Fortunately, there is enough experience to indicate that greater mobilization of domestic resources can be accomplished by economic policies designed to give proper incentives to thrift and enterprise.

No less important than the formation of material capital are the government's policies and programs to enhance the growth of human capital, especially by broadening the skills and know-how of the population. The scarcity of such assets is often a major constraint on the effective use of other forms of capital. One indicator of the government's effort in this field is the share of total current expenditures devoted to education. Other indicators are less precise; they require a qualitative evaluation of the government's program to raise the level of technical and managerial skills, improve its own administration, and ensure the participation of all sectors of society in the task of development.

Finally, the less developed countries have yet to give adequate recognition to the importance of taking measures to increase exports rapidly in order to meet development needs. Growth of exports can provide the foreign exchange for imports that are required for a higher rate of investment and economic expansion. Further, the mobilization of export earnings for development purposes presents less of a problem to developing countries than the mobilization of earnings in other sectors of the economy (e.g. peasant agriculture). Thus a rapid expansion of exports can not only widen the foreign exchange bottlenecks to investment expansion; it can also facilitate the achievement of a higher rate of savings.

The enormity of these problems and somewhat fitful progress in tackling them has given rise to a growing feeling of disappointment and frustration in the developed countries over the results of the development effort so far. As a result, there are now increasing signs in some countries, particularly the United States, of the weakening of will to help the development efforts of the poor countries. Other developed countries are increasing their programs, but not sufficiently to offset the declines.

The origins of a number of the development assistance programs that are in operation today can be traced back to the days of the "cold war", when aid was conceived as part of a global strategy to win friends and influence people; the assistance, in brief, was recommended on the ground that it would help build bulwarks against communism. In other cases, assistance was urged more positively to strengthen democratic institutions in the less developed countries. The spread of neutralism in the Third World, and the inability of democratic institutions to flourish in an environment of direst poverty and social tension, were read by some as indictments of assistance to such countries, or at least, as reasons for reduced support.

As the political will in favor of development assistance has weakened, arguments opposing an increase in such assistance have gathered strength in some, though not all, of the developed countries. Arguments have been made that budgetary or balance-of-payments difficulties prevent an increase in aid; that the increase would in any case not be justified since so much of the aid already given has been "wasted"; that too much of the aid has been used for satisfying political whims and building prestige projects; and that the developing countries must learn to mobilize and use their own resources more effectively before they ask for bigger "handouts" from the developed countries.

At the root, however, the inspiration for such arguments comes largely from the circumstance that a number of the objectives which the developed countries hoped to achieve through their aid programs have not been achieved in the short run. In the process, the long-term objectives have been fading away from public conscience. The real crisis of aid today is that the marriage between the long- and the short-run objectives has not been worked out. Although the objective conditions exist for much more successful development than in the past in most of the developing countries, unfortunately the will to help them take advantage of these conditions has been greatly weakened. Evidence of political or social instability in a developing country is used as an argument for cutting off assistance for the development effort -- when, on a longer view, that assistance would promote the development that could moderate the political and social instability, and bring closer the day when the country could achieve a reasonable degree of continuing stability. There is a tendency to forget that development is a long process, calling for a great deal of patience and persistence. And, among the many prescriptions so dear to modern economists, there is none yet for "instant growth".

The danger implicit in the present situation is that, if current trends continue, the gap between the richer and the poorer nations will continue to widen. Although in per capita income terms, the growth in the latter has not been far behind, in absolute amounts the growth of the richer nations has been a great deal higher, because they have moved up from a much higher base. In other words, if a poor country starts from a per capita gross national product base of \$100 and achieves a growth rate of 2.5%, its gain at the end of a year is only \$2.5. By contrast, a richer country, starting from a per capita gross national product base of, say, \$1,000 and achieving a growth rate of 3% does far better in absolute terms by recording a gain of \$30. The example actually understates what is happening today, since in fact many of the poor countries have not yet reached a per capita income of \$100 per annum, while the developed countries include a number whose per capita income is over \$2,000 and \$3,000. The already dangerous gap between the two is now widening with startling rapidity.

In a world composed of isolated communities, the widening of the gap might not have mattered as much. But, in the world of today, spectacular improvements in communications and transport have brought nations and peoples into closer contact with one another. Through such media as films, television and radio, people in poorer countries have acquired some knowledge of the quality of life enjoyed by their more fortunate counterparts in the richer nations. From that knowledge has risen a tidal wave of new expectations in the poorer countries -- expectations which the leaders of these countries are in no position quickly to fulfil. The problems of the "statistical gap" are thus compounded by those of the "expectations gap". The more intractable the two become, the more powerfully are the leaders of the poorer countries propelled into a search for explanations and excuses. Not surprisingly, the search proceeds by finding the reasons for failure in the policies of the richer nations, and particularly in their aid and trade policies.

The question arises: What can be done to change current trends and ensure a less discouraging future? It is obvious that the principal ingredients for ensuring a better future must come from the developing countries themselves. The vast array of problems that the developing countries face within a framework of low economic output and productivity cannot be dealt with effectively unless there is the national determination to give the highest political priority to development. Widespread poverty can not be neglected without threatening the very existence of the countries; their solution is thus not distinct from the problem of national survival; in fact it is the heart of the problem. The national priorities of the poorer countries must in practice reflects these concerns. Moreover, the poorer countries cannot escape the fact that economic development is an all-embracing process. It involves the creation of new and the reshaping of old political, social, economic and financial institutions. It involves the evolution of a whole framework of policy instruments and techniques to structure and guide the direction and the pace of change.

It is not sufficient that the less-developed countries expand their physical capacities -- in roads and railways, power plants and irrigation works -- however important these may be. An equally important and more difficult task is to work out development strategies and to make certain that they are implemented within the framework of a coordinated and efficiently functioning administrative system, and to make the institutional changes required for balanced economic growth, while protecting cultural values from unnecessary annihilation by the forces of change.

Thus, the commitment to development needs to be translated into more effective policies and actions. For instance, sustained efforts are required to mobilize domestic savings for investment through better tax systems and an improved framework for savings. Policy measures to curb inflationary pressures and to maintain economic stability can be conducive to growth in real terms, as they assist both savings and exports. In addition, policies aimed at establishing and maintaining a realistic rate of exchange can be of great assistance in promoting the growth of exports. In many countries there is scope for improved tax administration to help make budgets a more effective tool of economic policy. Greater responsiveness to private foreign investors will certainly help. There is also a need for greater receptivity to modern technology in all its forms -- not only in the building of factories and infrastructure facilities, but also in the organization of schools, accounting practices, public administration and corporate management.

Given a readiness to accept changes such as these, there is no reason for any country to conceive a "ceiling" on its ability to develop, whether that ceiling be in the form of a growth rate target of 3% or 5% or 7%. Instead, it can expect to achieve much more if it seriously tries to do so. Nor is there any reason for it to jettison its old cultural values in the transition to modernity; in almost every developing country, there can be found sectors of activity where the most modern technology has been adapted to and reconciled with the preservation of the cultural heritage.

As far as the developed countries are concerned, there is inadequate realization of the fact that the contribution sought from them for the development effort is by no means excessive. The most they can do will still be very little in relation to their capacity. However large the figures may seem in absolute terms, their contribution to development cannot constitute anything more than a very small fraction of their resources -- whether judged by their gross national product, their domestic public investment programs, their total budgets, their total private consumption, their exports, or their supply of talent. Taking the gross national product measure, for instance, it is estimated that the combined annual gross national product of the industrialized countries has increased by more than $750 billion during 1960-68. Over the same period, the increase in the annual flow of official development assistance has been only $1.8 billion; even if private flows are counted in, which can fluctuate very widely from year to year, it is still only about $4.5 billion. It is estimated that the developing countries are capable of absorbing -- usefully, productively and efficiently -- about $5 billion more of external resources than they are getting at present. Even if the developed countries were to provide this extra $5 billion to development in the immediate future, the new total would represent only a very small proportion of their resources. It would still be less than 1% of the combined gross national product of these countries -- the target already accepted by the developed countries and endorsed by the Commission on International Development headed by Mr. Lester Pearson.

One per cent of gross national product can hardly be described as too large a contribution to make towards stimulating a development effort that has, on balance, brought promising results, despite the many set-backs and failures. Providing resources of this order on a continuing and more assured basis would not only give a greater impetus to the growth of the less developed countries; it would also bring a tremendous pay-off in terms of the future peace and security of the world. Seen in this perspective, the problems of international economic development might command a better understanding. But the difficulty is that a decision on the question as to whether more resources are to be allocated to development assistance or to something else is a decision that is made at the margin. Legislators find even budgetary increases hard to accept, because these increases have to be at the cost of something else, whether that something else be defense, or a space program, or domestic welfare schemes. Thus, it is at the margin that priorities come into sharp conflict and the tough decisions have to be made. Moreover, the fact that everywhere in the developed world there are urgent needs for large public investments and other expenditures, coupled with rising private investment and consumption,must be recognized. It is in this environment that, to say the least, in some of the major donor countries the priority given to development assistance has not been increasing; in the United States, it has in fact been declining. In this sense, there is an urgent need today to find a new definition of the developed countries' interests -- a definition that will redefine domestic priorities and show how these countries' own national interests are closely interlinked with the interests of the developing countries in economic development. That definition, unfortunately, remains to be clearly and persuasively formulated for the majority of the electorates in the developed countries.

The useful role that multilateral organizations can play in the development process has been increasingly recognized over the years. Because of this recognition, a variety of multilateral agencies have been established, such as the World Bank, the International Development Association, the European Development Fund, the European Investment Bank, the Inter-American Development Bank, the Asian Development Bank, and various United Nations agencies. However, contributions channelled through multilateral agencies still remain only about 10% of the total official flow.

While bilateral aid has an important contribution to make to the progress of the poorer countries, there is a strong case for giving greater emphasis to the multilateral approach in order to make the development effort more efficient and productive. The strength of multilateral organizations like the World Bank Group lies in the fact that economic development is their predominant objective; that they are permanent institutions and not apt to be diverted from helping countries to implement sound development strategies by short-run considerations of the sort that frequently influence the administration of bilateral aid. In a multilateral effort, it is also possible to draw not only the money, but also the technical and managerial skills, from a wide variety of sources, particularly from the private sector. To the extent that it facilitates internationational competitive bidding for the supply of equipment and services, it enables the developing countries to get better value for their money. Since multilateral organizations appraise country economic strategies and policies as well as provide finance according to objective criteria which are known to be in the best interests of the developing countries, it is easier for them to influence the economic policies and performance of developing countries. A continuous dialogue can be maintained with each country on what needs to be done, and what can be done.

The urgent necessity today is for a stronger development effort, and for a stronger emphasis on the role of multilateral organizations in this effort. With the impressive economic, scientific and technological progress of recent times, it is at last within man's power to eliminate poverty and build a better and safer world. The crisis in development is thus a crisis of national priorities within the developed and the less-developed countries, a crisis stemming from a failure to realize existing potentialities, not a crisis resulting from inability to succeed. There is no escaping the urgency and overwhelming importance of the need for more rapid growth and rising living standards in the poorer countries -- and also that the job can be done successfully -- but these facts are no guarantee that adequate policies will be stubbornly and persistently pursued. Statesmanship and leadership of the highest order are the greatest need in the international development effort. There is evidence that this need will be met as understanding of the problem deepens and widens.

FORM NO. 57 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

CONFIDENTIAL DEC 22 1969

TO: Files

DATE: December 19, 1969

DECLASSIFIED
MAR 26 2013
WBG ARCHIVES

FROM: Denis Rickett and John H. Adler

SUBJECT: First Meeting of Deputies on Third IDA Replenishment, Paris, December 15-16, 1969

This report supplements the official minutes which will be circulated to the Delegations of Part I countries.

1. Amount of Replenishment

The four Scandanavian countries, Canada and the Netherlands, accounting for 12.3% of the Second Replenishment, spoke unequivocally in favor of a "substantial" replenishment. The only figures mentioned in public were those mentioned by the Swedish Head of Delegation, Mr. Klackenberg, who spoke of a range of \$600 million to \$1,500 million. At luncheon however the Heads of Delegations of the countries mentioned above spoke openly of \$1 billion as their replenishment target. They also indicated their preference for replenishment on a rising scale with an annual average of \$1 billion.

The term "substantial" increase was also used by the U.K. and the U.S. Sir Geoffrey Wilson indicated privately that the U.K. was willing to accept and, perhaps in due course, officially propose a replenishment ending up at \$1,000 million. He mentioned as a possibility a sequence of \$800, 900 and 1,000 million. The U.S. likewise did not mention any figure in public, but indicated that the U.S. Administration favored multilateral aid and endorsed a replenishment at a "significant" level. Mr. Petty, the Head of the U.S. Delegation, also told Mr. Larre (France) that Larre's private suggestion of a \$500 million replenishment was "completely inadequate." The U.S. Delegation referred to the forthcoming report of the Peterson Commission, but also said that a decision on IDA would be made before the report was completed.

The remarks of the German Delegation were essentially friendly in a noncommital way but it was quite apparent that no decision regarding the amount had been made. It was explained that the German Medium-term Finance Plan was still in preparation and nothing could be said until it was completed. Italy made friendly noises, but did not take any position on the size of the replenishment.

Japan spoke about an increase in IDA replenishment and said that the size of her contribution would depend on a satisfactory adjustment of her voting rights.

The remarks of the Delegations of Belgium, Austria and Australia were so general that they did not reveal any position. Luxembourg did not take part in the discussion; neither did South Africa which was represented only by an Observer. The only decidedly negative position was taken by France. The French Delegation stressed the supplementary role of IDA with respect to bilateral aid, the fact that France exceeded the DAC 1% of GNP target by a substantial margin and that she therefore, unlike most other countries, had no room for an increase in IDA contributions under the 1% target and that an increase in IDA contributions would necessitate a decrease in bilateral aid.

2. Loans Instead of Grant Contributions

Only two countries spoke in favor of loan contributions. The German Deputy endorsed the idea of substituting loans for grant-type contributions because he felt that contributions which were neither subscriptions nor loans were not provided for in the Articles of Agreement and therefore "illegal." The French Delegation favored loan contributions on the ground that loans would be more appropriate at the present juncture to IDA's financial structure. All other countries were opposed to loans as an unnecessary innovation which might cause complications. The U.S. Delegation expressed strong opposition, pointing to the possibility that Congress might insist on charging interest on loans. The Netherlands Delegate reserved the right to make loans instead of grants to IDA if other countries made loans.

In connection with the subject there was a brief and perfunctory discussion on the terms of IDA lending. The Chairman pointed out that only 22 % of IDA credits went to pure IDA countries (18 in number) and that the others received IDA credits blended in varying proportions with Bank loans.

3. Voting Rights

The Bank proposal for the adjustment of voting rights to take account not only of the future contributions but also of the effects of the First and Second Replenishments was well received and generally accepted as a basis for technical discussions which are to be undertaken by a Working Party or Study Group which is to be convened in late January or early February in Washington. As indicated before, Japan appeared especially anxious to see voting rights adjusted. The German and French Delegates said that loans should not entitle countries to votes, but it was not clear whether they meant that loans should not even indirectly be taken into account in the allocation of voting rights.

4. IBRD General Capital Increase

This subject, which was not on the Agenda, was raised by the French Delegation at this meeting and taken up again at their request on the second morning. The reaction to a general increase was generally negative. The countries (Canada and the Netherlands) explicitly endorsed as an alternative to a general capital increase the suggestion of not transferring IBRD profits to IDA. Several other countries, including the U.K. and Germany, expressed the hope that transfers of Bank profits to IDA would continue even if a general increase was not forthcoming. The only exception to the negative attitude was that of the U.S. whose representative was in public vague and noncommital. Mr. Petty said privately that the case for a general increase was better than the Bank paper indicated. He asked for a paper on the trade-off between profit transfer and a larger replenishment; privately he explained that what he meant was a set of cash flow projections under different assumptions. He reserved the U.S. position on the transfer of Bank profits in view of possible Congressional opposition to a suspension of transfers. The French expressed doubts on the need for more capital because they thought that the Bank's lending and borrowing projections were too high. They said that a lower volume of Bank lending would make a general increase unnecessary and still permit a continuation of profit transfers to IDA.

5. Other Issues

A. Encashment Period: Interest in the extension of the payment or appropriation period to fit disbursements was limited only to a few countries. The German and British Delegations said their primary interest was that their contributions should be drawn upon an even and predictable level. The German Delegate said that Germany was willing to pay more than her pro rata share if this was necessary to maintain even payments. The U. K. Delegation indicated that it wanted even payments but would not want to make payments faster than the rest of the contributors. In this connection Sir Geoffrey Wilson expressed much concern about the absence of program loans in the disbursement projections and, more generally, about the slow rate of disbursements. He said that the U.K. contribution would depend on more lending for local expenditures and generally faster disbursements. Privately he said that the Management paid too much attention to the German, French and Netherlands Executive Directors on that subject.

B. Burden Sharing: This issue came up only peripherally, but indications are that it may well cause difficulties. Sir Geoffrey Wilson was most helpful by pleading for freezing the present shares (although he obviously would not object to increases). His suggestion was generally well received even by countries who in the Second Replenishment have made supplementary contributions and had insisted that they did not set a precedent for maintaining their shares at the level. Mr. Petty said that the

U.S had to reserve its position on burden sharing (and also on the question of balance of payments relief), but the statement was low-keyed and appeared to be made chiefly on legal and procedural grounds. The French Deputy indicated that France would claim a smaller share of IDA contributions because of her large bilateral aid program. He suggested as a possibility a low replenishment target in which all Part I countries would participate (and receive voting rights commensurate to their share) and that countries which had only small bilateral aid programs should be encouraged to make supplementary contributions and thus increase the size of total IDA resources.

(It is suggested that a counterproposal to the French suggestion along the following line be considered and perhaps tried out in bilateral discussions before the next meeting. The first objective should be to reach an agreement on a replenishment target -- with the understanding that the Scandinavian countries, the U.K., the U.S., Canada, the Netherlands, and, perhaps, Germany would accept contributions corresponding to their Second Replenishment share. France and perhaps other countries unwilling to accept a substantial increase in their contributions South Africa? Australia? would then be excused from meeting their share. Attempts should then be made to make up the deficiencies in the target by a further Swiss loan, a contribution from New Zealand, increased contributions from Kuwait, releases of 90% funds from Part II countries, repayments to IDA, cancellations and carry-overs from the Second Replement.)

C. Date and Place of Next Meeting: There was general agreement that the next meeting should take place at the end of February after Barbara Ward's conferences. As to the place, the general preference was for Europe. Sir Geoffrey Wilson extended an invitation to hold the next meeting in London. Another possibility for this or a subsequent meeting would be Vienna. The German reaction to a suggestion for a meeting in Germany was rather lukewarm.

cc: Messrs. McNamara
Knapp
Aldewereld
Friedman
Broches
Nurick
Adler
Blaxall
Brash

Mr. Robert S. McNamara December 5, 1969

Andrew M. Kamarck

DEC 8 1969

Paper For Board on Some Aspects of D.F.C. Policy

1. Mr. Diamond's draft paper seems to me to give the Board a clear statement of what the Bank has attempted to achieve in promoting and financing D.F.C.'s in developing countries.

2. I found the emphasis given in the paper to interest rate policy not only for ensuring the efficient allocation of resources but also as a condition for ensuring the effective mobilization of resources, particularly noteworthy. The point that "the presence of low-cost capital (and the hope of getting more of it in the future) may in some cases have deprived a D.F.C. of the discipline of raising capital on market terms and may thus have diminished its potential role as a mobilizer of private capital," could be emphasized even more. Certainly the performance of most of the DFC's in this regard has failed to come up to expectations. An examination of their sources of funds shows that they have operated predominantly as institutions through which foreign funds and domestic budgetary funds have been channelled into private industry.

3. I wonder whether this paper might not provide an opportunity to make known to the Board the new initiatives Mr. Diamond has taken recently to strengthen the economic aspects of his Department's operations. Firstly and most obviously is the creation of the new post of chief economist within his department. Secondly, is the initiative and support given to economic work on problems of industrial policy (e.g. Iran) and of industrial project appraisal methodology (e.g. Turkey). Thirdly, is the work which has been commenced in collaboration with Mr. Please's Domestic Finance Division in the Economics Department.

4. This latter work has arisen out of Mr. Please's responsibility for examining problems in the general area of private savings mobilization in developing countries. As already noted, DFC's themselves have been less effective than originally visualized in mobilizing domestic private funds and Mr. Diamond is currently alerting the managements of most of them to the fact that the Bank will in future be placing much greater emphasis on their role in this regard. There are two general points at issue here.

5. Firstly, is the statement in Mr. Diamond's paper (paragraph 6) that "... the principal responsibility for devising and pursuing policies to promote effective resource mobilization ... rests with governments, not with DFC's. Furthermore, DFC's must work within the framework of existing government policy and can do little to assure

effective mobilization ... of resources where policy is not conducive in the first place." In a formal sense this is obviously true and in substance it is also true for some countries. The statement does, however, appear to play down the prestige and position which both the DFC's themselves and their chief executives have in their countries.

6. Mr. Please reports that he feels this is the case in the two countries he has just visited - Iran and Taiwan. In the former IMDBI has a towering position among the financial institutions and is led by a very able and dynamic management which sees its responsibilities as extending beyond those of the institution itself. In the case of Taiwan the CDC is in a less dominant position but it is highly respected. Most importantly in the case of Taiwan it appears that the government is looking for new policy directions in regard to the mobilization of private savings and would welcome initiatives set by the CDC. In fact it would seem that the government might be expecting CDC to play a much more dynamic role than CDC itself intends in this regard.

7. The second general point is that if these judgments on IMDBI and CDC are accepted and if they are more widely relevant, it would follow that the Bank itself should be aware of the changes in the policies of DFC's which are required so that it can use its influence to implement them. A starting point in this regard should be country economic reports. Where these reports have focussed on the private savings problem it is an obvious next step to pursue the implications for the DFC's of the analysis and policy conclusions the reports contain. This has been the case in Taiwan and to some extent in Iran. It is also apparent that it has occurred in the cases of Brazil and Ecuador. It is through the relationship we are developing with Mr. Diamond's department that we are hoping to support in country economic analysis the initiatives he has taken in regard to the role of the DFC's in the mobilization of domestic private savings.

cc: Mr. Friedman
Mr. Diamond

SPlease/AKamarck/vhw

Form No. 57

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

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: December 3 1969

FROM: Irving S. Friedman

SUBJECT: Indicative World Plan for Agricultural Development

I think you will find the attached brief memorandum on the FAO Indicative World Plan interesting.

Mr. Manning is a member of the Sector and Projects Studies Division in the Economics Department.

ISF

Att:

DEC 10 1969 (2 pm)
(Returned)

President has seen

OFFICE MEMORANDUM

TO: Mr. Irving S. Friedman

DATE: November 26, 1969

FROM: Richard C. Manning

SUBJECT: The F.A.O. Indicative World Plan for Agriculture (I.W.P.A.)

DEC 1 1969

9 a.m.

1. A first reading of this report is, in general terms, a depressing affair. It was born in the spirit of 1960 in which neo-Malthusian gloom was a dominant theme and has proceeded to grind its way to a shambling halt in 1969 without having established the intellectual and mechanical facilities for updating its results during one of agriculture's most explosive decades. Unforseen plummetting of fertilizer costs, the fruition of years of research for more responsive varieties, especially among the crucial cereals, and an adherence to protein - carbohydrate ratios that are no longer regarded as sacrosanct all contribute to making the report considerably out of date.

2. The Plan is difficult to interpret as such. The laudable objectives of lowering production costs and freeing world trade, so as to broaden the foreign exchange earning capacity of developing countries, establish a firm base on which the Plan will be supported. However, few observers of world agriculture would need a $6 million study lasting four years to confirm them in such conclusions. All true planning will eventually take place in a national context and, without doubt, the background papers to the I.W.P. will be most useful material in relating national plans to regional and world-wide trade and production possibilities.

3. The conclusions of the analytic work are nowhere near so dismal as even the report makes out. An extrapolation of past trends in cereal production would be sufficient to meet 1962 per caput consumption requirements of the expected 1985 population. In fact, since 1962, cereal yields have been nudged up rather faster than the trend and so there is even a little freeboard in the system. The big task comes in generating an improvement in production that would be compatible with a 5.6% annual growth rate in G.D.P. Unfortunately the Plan never comes properly to grips with the simultaneity of levels of G.D.P. and production in the agricultural sector. There are various references to the incompatibility of projected outcomes, but the interaction through the market structure is not made explicit. It is an all-or-nothing statement of the problem and does not supply the parameters to allow determination of other consistent solutions.

4. The Plan contains many recommendations that imply considerable flexibility at the national level and yet foreign exchange deficiencies are seen as a dread spectre rather than one more area for flexibility in the light of national priorities. Foreign exchange is available at a price, but the I.W.P. does not make it unequivocally clear that this price is too high in terms of the other ingredients of development.

5. It seems incredible that a study of this magnitude was not formalized to the point at which automatic computation would have allowed immediate updating of the results. It is virtually impossible to derive the implicit 1970-1985 growth targets since the performance 1962-1969 is not treated in a comparable fashion. Here and there one finds hints concerning performance since the base year and it is just enough to make one realize that any model so complex that it cannot be updated with modern facilities is, operationally, useless.

6. The summary volume (III) has every sign of being put together very hastily. Inclusion of nonsense tables such as Table 5 (page 8), based on totally incompatible demand and supply hypotheses, and prediction of a 46% decline in cropping intensity in Latin American irrigated areas (Table 10, page 23) will only provide ammunition for critics of F.A.O.

7. It is reported (The Economist, November 15, 1969 page 75) that these documents are now under study by some 1,000 country representatives in Rome; it would seem that not even F.A.O. is clear as to what the conclusions are. If, however, some concensus arises from these discussions about the applicability of I.W.P. projections at country and regional levels, then, with a considerable effort, the general order of magnitude of investment opportunities in agriculture could be derived from the study. Since all projected needs in research, extension, credit, marketing and irrigation development are keyed to meeting the target 3.9 percent growth rate in agriculture, adjustment of these implicit needs for other growth rates would not be an easy matter. As an aid to Bank policy formation, the I.W.P. is of little immediate use, but the background work undertaken in the regional studies (mostly completed in 1966) has already had its impact in providing better informed public servants in ministries all over the world.

cc: Mr. R.M. Sundrum
Mr. S. Takahashi
Mr. H.G. van der Tak

RCManning/wj

FORM NO. 57 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: November 28 1969

FROM: Irving S. Friedman

SUBJECT: Ninth Conference of Central Bank Technicians of the Western Hemisphere

I think you will be interested in reading the attached memorandum. Tamagna is both very experienced and a careful reporter.

It is particularly interesting because Central Banks of Latin America have as a group, been among the least nationalistic and most pro-American parts of the various governmental agencies.

ISF

DEC 1969 (5 p.m.)
Returned

Att:

President has seen

FORM No. 57 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Irving S. Friedman DATE: November 26, 1969

FROM: Frank M. Tamagna

SUBJECT: Reaction to Central Bank Meeting

NOV 26 1969
3 pm

As I informed you, I have attended the Ninth Conference of Central Bank Technicians of the Western Hemisphere, that was held in Lima from the 17th to 21st of this month, under the auspices of the Central Reserve Bank. As invited guest, I presented a paper on the role of foreign investments in the future of Latin America, with particular regard to the contribution of investments by financial intermediaries and multinational companies in the formation of national financial markets and the economic integration in the area (copy of which I gave to you before my departure). My topic was closely related to a principal paper on the role of foreign banks in Latin America, that had been submitted by Mr. Miguel Wionczek from CEMLA; other papers discussed a model of monetary analysis, export financing, reporting of foreign indebtedness (presented by the IBRD), and a general review of monetary developments in the area since the previous meeting (held in 1966).

The following is my general reaction to the meeting:

(a) There was a large and vociferous rise of nationalistic feelings, with little recognition even of Common Market and integration goals that had been so prominent in previous reunions. This nationalistic trend reflected in particular an anti-American sentiment, extended, however, to European countries as well.

(b) The discussion on the role of foreign banks was strongly biased against, on the ground that their branches divert domestic savings and credit to the financing of foreign firms and investments, in ways detrimental to local initiatives, tend to absorb dollar funds from the area for use elsewhere, and help flight of private capital.

(c) In the discussion of foreign investments the view was expressed that whatever innovations (whether technological or managerial) foreign companies might bring could be acquired directly by domestic firms, without subjecting themselves to economic and political control from the outside.

(d) The recommendation was advanced that Latin American countries should agree among themselves on terms, conditions and priorities be "demanded" from foreign investors, so as to avoid any competition for investments among the Latin Americans themselves and to force would-be investors in Latin America to accept such conditions or to stay out entirely from the area.

There were some (but few) voices raised by Latin American delegates to contrast these extreme points of view. The task of defending the traditional "conservative" positions fell mainly on the U.S. and Canadian delegates and an observer from the Bank for International Settlements (Mr. Rainoni). It is to their credit that they succeeded in attenuating such extreme nationalistic positions in the final conclusions of the meeting - and perhaps also in introducing some doubts in the minds of the Latin American delegates themselves with respect to their own views.

11/24 To Mr. Friedman
Please discuss with Mr. Demuth for possibly including these ideas in re Pearson Commission Recommendations.

FORM NO. 57

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

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: November 20, 1969

FROM: Irving S. Friedman ISF

SUBJECT: Some Ideas on Bank/Fund Collaboration

NOV 24 1969 (Returned) 10 a.m.

We have been preparing a paper on Bank/Fund collaboration on economic missions and reports, both in response to the Pearson Commission recommendations and also as a consequence of our discussions on how we might mesh together more effectively Bank and Fund economic missions and reports now that we have undertaken a schedule of regular annual, biennial and triennial missions. We have prepared a draft paper which I intend, together with Mr. Knapp, to discuss with the Area Departments. Unless you would want to see the present paper I would not wish to bother you with it until we have a revised version based on these discussions. The Fund is also having active discussions on this matter and Mr. Southard has promised to contact me shortly to give me the outcome of their staff deliberations.

However, at a time when we are thinking about Bank/Fund collaboration, I would like to present briefly a few ideas to you personally. I hesitate to present them even briefly as they are rather far out and may well be deemed impractical. I am not discussing them with my colleagues in the Bank or with people in the Fund.

(1) A common economic service between the two agencies. Most of the economists in the two institutions have similar backgrounds, particularly in their basic academic training. I believe that if people were hired to work in a common economic service field and the function of the two institutions represented the breadth and scope of their future careers, it would be easier to recruit better people and to keep them, as well as enrich the work of both institutions. It would mean that people would not only be able to move between the two institutions, which theoretically they can now, but that it would be at least as easy as it is now, to move between institutions as from one department to another within each institution. (I do not expect that this idea would be well received by many in the Bank and Fund. The idea would have best chance of acceptance if it originated with the President and/or Managing Director.) If this seems impractical or otherwise unwise, it might be more feasible to have a joint statistical service. This could be headed by a Director and Associate Director, or even two co-directors.

(2) The EDI and the IMF Institute could be made a joint effort. In the past the Fund has taken the attitude that they were not ready for this step as the EDI was well developed and their own effort was rather small and in its early stages. However, they might be ready to consider this now because their program seems to be well developed.

(3) If the EDI and the IMF Institute were combined, it might also be desirable at some point to expand the activities of such a combined institute to include long-term basic research. In this way we could develop under the sponsorship of the Bank and the Fund, an international development

and finance center to which would come not only government administrators needing certain basic training, but also scholars who would carry on long-term research work of importance to these institutions. The amount of funds spent anywhere on innovative long-term research in the development and monetary fields is very small compared with the need.

(4) Another field of possible joint work is with respect to the Economic Committee. The Bank's Economic Committee does have the participation of the Fund staff -- their participation has been sustained and active. It is conceivable, however, that instead of having an Economic Committee of the Bank there could be a Joint Economic Committee of the Bank and Fund to review both the country economic reports of the Bank and the consultation reports of the Fund, as well as any other common economic policy questions which may be referred to it. In time we might even aim to have discussions on a country take place on the same day to the extent feasible. At present there is no body in the Fund corresponding to the Economic Committee of the Bank. The review procedure for Fund consultation reports is quite different. The preparation of reports is the joint responsibility of the Area Department concerned and the Exchange and Trade Relations Department, both of whom contribute staff to each mission. The Directors of these departments are responsible for reviewing the reports. They are often read over by the Deputy Managing Director, and at times the Managing Director, before they go to the Board. From time to time there are meetings held by the Managing Director or his Deputy on these reports when there are important issues to be discussed, especially in the proposed recommendations for Board action.

There are a number of arguments which may be made against a joint Bank/Fund economic committee, including the obscuring of institutional responsibility, the introduction of an additional piece of machinery, and that existing informal and formal arrangements already achieve the objectives of the suggestion. However, it would be evidence of our desire to achieve, to the extent possible, an integrated point of view on country situations and policy performance. This is particularly important as the world increasingly looks to us to make judgments on adequacy of economic performance. We now have close collaboration, but not an integrated point of view and the advice given would probably have much greater weight and influence.

IDA allocation
Ravum burns

Mr. Robert S. McNamara

November 19, 1969

J. Burke Knapp

NOV 19 1969
3.45 p.m.

Suggested IDA Allocations for 1972 - 1974

Please find attached a table which sets forth my suggestions as to how IDA funds might be allocated in 1972 - 1974 at varying levels of replenishment. You will find the table largely self-explanatory, but I offer the following comments:

1. The table applies the principle of reducing the percentage allocations to the three principal IDA recipients as the level of the replenishment rises, thereby releasing additional funds for the purposes of "geographical diversification". The principal diversification is in the direction of Latin America, specifically toward Brazil and Colombia. Other countries in Asia and Africa would also be beneficiaries, but not particularly French sub-Sahara Africa, which is already being treated generously in the allocation of IDA funds.

2. For the time being I have formulated these suggestions entirely in terms of IDA credits, without introducing the idea of IDA subsidies on Bank loans.

3. Please note the per capita allocation figures in the final column, based upon "adjusted" population figures which reflect the degree to which the country concerned would be relying upon IDA funds in the financing which they obtain from the Bank Group (i.e. the hardness or softness of the IDA blend). In this connection I have made some adjustments, usually in the direction of greater softness, in the blends which we are currently using.

4. All of these figures are somewhat schematic, being rounded off and taking little if any account of barriers that may be raised to IDA lending in particular countries by reason of political upsets, bad economic performance, failure to produce promising projects, etc. It should be noted on the other hand that no allowance has been made for possible IDA lending to the Mekong group of countries, which could within the time period envisaged here, become an important claimant on IDA funds.

Attachment

cc: Messrs. Aldewereld, Sir Denis Rickett
Friedman
Adler

JBKnapp:dk

IDA: ALLOCATION OF THIRD REPLENISHMENT BY COUNTRY
(Assuming annual replenishment of $ 400,600,800 and
1,000 million a year over the FY1972-74 period)

(Amounts in $ millions)

Country	IDA Blend	Population (millions)	Adjusted Population a/ (millions)	FY1969 Actual Credits	FY1972-74: Alternative Levels of Commitment Authority 500	700	900	1100	Per cent of Total IDA Credits per annum FY1969	500	700	900	1100	$ Per Capita of adjusted population at $1100 level
India	straight	511	511	152.5	200	260	320	380	39.6	40.0	37.1	35.6	34.6	.74
Pakistan	straight	120	120	48.0	50	65	80	95	12.5	10.0	9.3	8.9	8.6	.79
Indonesia	straight	110	110	51.0	50	65	80	95	13.2	10.0	9.3	8.9	8.6	.86
Total		741	741	251.5	300	390	480	570	65.3	60.0	55.7	53.4	51.8	.77
Other Asia & Middle East														
Korea	medium	30	15	18.3	10	15	20	25	4.8	2.0	2.1	2.2	2.3	1.67
Turkey	medium	33	17	12.0	10	15	20	25	3.1	2.0	2.1	2.2	2.3	1.47
U.A.R.	straight	31	31		20	30	40	50		4.0	4.3	4.4	4.5	1.61
Other	b/	40	37	19.9	25	35	50	65	5.2	5.0	5.0	5.6	5.9	1.76
Total		134	100	50.2	65	95	130	165	13.1	13.0	13.6	14.4	15.0	1.65
Africa														
Fr. Sub Sahara Africa	c/	44	36	39.4	35	55	75	90	10.2	7.0	7.9	8.4	8.2	2.50
East Africa	d/	30	17	20.9	20	30	40	50	5.4	4.0	4.3	4.4	4.6	2.94
Ethiopia	medium	24	12		15	20	25	30		3.0	2.8	2.8	2.7	2.50
Other	e/	78	47	8.4	40	55	75	95	2.2	8.0	7.9	8.3	8.6	2.02
Total		176	112	68.7	110	160	215	265	17.8	22.0	22.9	23.9	24.1	2.37
Latin America														
Brazil	hard	86	22			20	30	45			2.9	3.3	4.1	2.05
Colombia	hard	19	5			10	15	20			1.4	1.7	1.8	4.00
Other	f/	28	15	14.6	25	25	30	35	3.8	5.0	3.5	3.3	3.2	2.33
Total		133	42	14.6	25	55	75	100	3.8	5.0	7.8	8.3	9.1	2.38
GRAND TOTAL		1,184	995	385.0	500	700	900	1,100	100%	100%	100%	100%	100%	1.16

a/ The "adjusted" population includes: 100% of the population for "straight" IDA countries, [illegible] for "soft" blend countries, 50% for "medium" blend countries, and 25% for "hard" blend countries. The adjustment is made on estimated population in 1967 (World Bank Atlas - 1969)
b/ Includes: Afghanistan (straight), Ceylon (soft), Nepal (straight), Papua & N. Guinea (straight).
c/ Includes: Cameroon (medium), CAR (straight), Chad (straight), Congo (B) (straight), Dahomey (straight), Ivory Coast (hard), Malagasy (soft), Mali (straight), Mauritania (straight), Niger (straight), Senegal (soft), Togo (straight), Upper Volta (straight)
d/ Includes: Kenya (medium), Tanzania (medium), Uganda (soft).
e/ Includes: Botswana (straight), Burundi (straight), Congo (K) (soft), Gambia (straight), Ghana (soft), Lesotho (straight), Liberia (medium), Malawi (straight), Mauritius (straight), Morocco (hard), Rwanda (straight), Sierra Leone (medium), Somalia (straight), Sudan (medium), Swaziland (straight), Tunisia (medium).
f/ Includes: Bolivia (straight), Dominican Rep. (soft), Ecuador (medium), Guyana (medium), Honduras (medium), Paraguay (medium), El Salvador (hard), Guatemala (hard), Nicaragua (hard).

P & B 11/19/69

FORM NO. 57

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

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara DATE: November 17, 1969

FROM: Irving S. Friedman

SUBJECT: Division of Functions between the Industrialization Division of the Economics Department and the Industrial Projects Department

You will recall that before you left you asked me to look into the question of the division of functions between the Industrialization Division of the Economics Department and the Industrial Projects Department. The attached memorandum represents where we have come out as a result of discussions involving the people mentioned in the memorandum, as well as Mr. Chadenet and myself. You will note that the principle for division of labor set forth for the industrialization work is recommended for the fields of population and urbanization as well.

It is our plan to promote Mr. Kenneth Bohr (who is at present in India) to this position in the Economics Department. We are also transferring one position from the Industrialization Division to the Industrial Projects Department.

Mr. Chadenet is aware that I am sending a copy of the attached memorandum to you, as well as this covering note.

ISF

cc: Mr. Ripman

Note: Discussed with Mr. Baum, who said he would clear it on behalf of Mr. Chadenet.

Mr. Bernard Chadenet November 17, 1969

Irving S. Friedman

Division of Functions between the Industrialization Division of the Economics Department and the Industrial Projects Department

I have been looking at this problem over the past few weeks and I understand that it has been discussed at various times by Messrs. Baum, Fuchs, Stevenson and Kalmanoff as well as yourself.

There are two areas where confusion or overlapping might occur:

(1) advice on industrialization matters;

(2) sector work.

One has to start from the position that the Projects Departments are operating or line units and that dealing with governments is one of their responsibilities, while the Economics Department is a support or staff unit dealing (except as regards research or similar matters) mainly with other departments of the Bank. One of its functions is to be the research arm of the Projects Departments. It follows from this that staff members in the Economics of Industrialization Division of the Economics Department would give advice to the Industrial Projects Department, as requested, on industrialization problems but would not advise, say governments, except by arrangement with the Industrial Projects Department. This would be made explicit by adding the underlined words to the relevant portion of the Organization Bulletin describing the functions of the Economics Department:

> "Its specific functions are:
>
> ......
>
> to undertake operational research and advise other departments as requested on problems and policies in the field of industrialization " ....

The second problem concerns sector work. The responsibility for following developments in the fields of industry lies with the Industrial Projects Department as set out in paragraph 10 of the suggested revised draft of the Organization Bulletin describing the functions of the Projects Departments and circulated by Mr. Ripman on October 28. The Industrialization Division of the Economics Department would be involved in this only when its support was deemed desirable by both parties, for instance because a particular piece of analysis was required which the Division was best equipped to provide, because participation, say in a mission, would advance the research work of the Division, or because the staffing positions of the two units made this appropriate.

The same general principles already guide the working relationships between the Sector and Projects Studies Division of the Economics Department and the Agriculture, Public Utilities, Transportation, and Education Projects Departments, and I think they should also apply in the fields of population and urbanization.

AStevenson:js

cc: Messrs. Baum
Ripman
Kamarck/Stevenson

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

INTERNATIONAL FINANCE CORPORATION

November 17 1969

Mr. Stevenson to send memorandum for Mr. McNamara on outcome of his talks with Chadenet of division of labor between Projects Dept. and Economics Dept.

FORM NO. 57 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Irving S. Friedman

DATE: November 14, 1969

FROM: George Kalmanoff G.K.

PERSONAL AND CONFIDENTIAL

SUBJECT: Role of the Economics Department vis-a-vis the Industrial Projects Department

1. I feel there is justification for an industrialization unit in the Economics Department, despite the establishment of the Industrial Projects Department, basically because I think it is desirable to separate day-to-day Bank operations in the field from work on problems of general significance which are thrown up by the day-to-day operations. This is, of course, not to imply that the two aspects should be divorced; each aspect would suffer if isolated from the other; a cooperative link is necessary.

2. Work on the aspects of industrialization to be carried out in the Economics Department should include:

a) Keeping up with and synthesizing for Bank management and operators developments in current thinking in academic and other research circles;

b) carrying out comparative studies, based on Bank individual country sectoral and projects studies, to generalize from our own experience and to add from it to world thinking on the subject;

c) analyzing the methodologies applied by the operators in sectoral studies and project work;

d) participating in operational work, particularly on industrialization strategies and policies of individual countries, on a selective basis, both to keep "au courant" with operational developments and to contribute with the kind of expertise characteristic of primarily research-oriented personnel.

3. It could be argued that such work on general problems of industrialization might just as well be done by the Industrial Projects Department, perhaps in a separate division. If this is accepted, it should logically also be applied to the other units in the Economics Department that have operational counterparts (the Sector and Projects Studies Division for agriculture, transportation, education, and public utilities; the Population Studies Division; and the Urbanization Division, eventually). This would then reduce the Economics Department to units that have no operational counterpart (Trade Policies and Export Projections, Statistical Services, Domestic Finance, Quantative Techniques and Analysis). The principal argument against such a transfer of functions is that the pressure of operational requirements in the Projects Department would tend to lead to a reduction in emphasis on the more general work. As a realistic matter, it is better to have such work supervised by the Front Office of the Economics Department than by the highly pressured Front Offices of the Projects Departments. The success of the separation, however, depends on the personal qualities and attitudes of the personnel involved.

4. Assuming existence in the Economics Department of an industrialization unit with the functions listed above, the question then arises as to whether it should be a unit in the Sector and Projects Studies Division, which already has units covering other sectors: agriculture and transportation (5 persons for each), education and public utilities (1 person for each). In principle, this seems logical. In practice, industrialization, being a self-contained field of vast scope, complexity, and operational diversity in the Bank Group (besides the Industrial Projects Department, there are the entire I.F.C. and the Development Finance Companies Department also concerned with it), requires a professional staff of some size and the full-time attention of a supervisory Chief. There seems to be no point to loading the Sector and Projects Studies Division Chief with this additional responsibility.

5. Primary responsibility for industrial sector studies in individual countries should be with the Industrial Projects Department, with the cooperation of the industrialization unit of the Economics Department to the extent indicated under 2d). This is necessary to broaden the basis for its own work in project identification, preparation, and appraisal. This will, however, be the most difficult part of its work to organize and carry out. The manpower requirements of a serious effort are very great. The issue of proper handling of this work has not yet been resolved. The operational requirements by which Projects Departments are pressured, referred to in another connection in paragraph 3, mean largely work on project appraisals for Bank financing. Just as there would be an understandable tendency to de-emphasize non-operational work, there could be one of de-emphasizing sectoral work because of the pressures of projects work. A deliberate effort has to be made to keep this from occurring - through adequate staffing, and perhaps even through separation of the functions of the Department into divisions dealing respectively with project appraisals and sector studies.

GK:yib

FORM No. 57 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Alexander Stevenson

DATE: November 4, 1969

FROM: A. J. Macone

NOV 5 1969

10 e.—

SUBJECT: Briefing for Mr. McNamara on petroleum

1. I think this memorandum will make better sense than otherwise if I begin by stating what I understand to be the specific points on which briefing is desired regarding the world and Iranian petroleum situation. The points are as follows:

(a) Basic facts about the world petroleum industry (it is understood that "world" in this memorandum excludes the centrally planned countries except when otherwise indicated).

(b) Comments on a number of specific questions on the world petroleum market, which I understand to be:

(i) To what extent is the flow of trade affected by the technical qualities of various crudes?

(ii) What are the constraints set on world trade flows by government policies?

(iii) What shifts have taken place in the direction of trade by major countries and companies?

(iv) What do we know about joint ownerships and what is their significance?

(v) What do we know about the contractual terms under which companies produce oil in foreign countries?

(c) In addition, we have been asked to prepare two tables. One is to show the following: major company production in each of a selected list of countries; the product marketings of each major company by major consuming area; current oil reserves by country and expected production by country in the mid-1970's or the 1980's. The other table is to show Iran's crude oil production in barrels and its value in dollars, year by year, 1959-1969.

(d) We have also been asked to comment on the oil export projections of the Iranian Government and the Bank Mission, and on any negotiations between the Iranian Government and the companies operating in Iran.

2. The first table mentioned in 1 (c) above is attached as Table 1. However, one piece of information is missing from it, namely, projected future oil production by country. Most governments or companies have not published such estimates in recent years. We ourselves have made an estimate of aggregate LDC production in 1975 in our paper "Recent and Prospective Trends in the World Petroleum Industry", prepared by Andrew Huang in February 1968 (attached as Annex I). That estimate, however, was arrived at by projecting OECD demand and then projecting OECD production (i.e., in the U.S. and Western Europe) on the basis of an OECD study. We then allocated the resulting 1975 projected OECD import deficit between the LDC's and the USSR. The aggregate production projection appears in Table 14 of Annex I, but we have thus far hesitated to break it down by country since this would involve more guessing than has been required for operational purposes. We have, therefore, shown in Table 1 growth rates in production by country for two different postwar periods, 1955-1968 and 1960-1968, to suggest how the competition for increased shares is progressing. Excluding the African newcomers, whose growth rates are still too much influenced by their status as new entrants and the brevity of the period since some of them have become substantial exporters, it will be noted that Iran leads the field. This reflects in part Iran's position as a probable low cost producer and a profitable area of operations for the companies,1/ and in part a good bargaining position in dealing with the major oil companies. The country's political stability and basic alignment with the West undoubtedly are important factors in its oil negotiations.

3. It is worth noting, however, that Saudi Arabian production also has been growing faster than average, even though profitability there may be considerably lower than in Iran (Table 11, Annex I). This suggests that political stability and basic company-government rapport, despite surface controversy, probably carries as much weight in the bargaining as profitability.

4. Table 2 shows Iranian production (in barrels and tons). We have included a line showing f.o.b. export values of Iranian petroleum for 1962-1967 (culled from the Bank's Economic Mission Report) but these may be meaningless for most purposes since, as footnoted, they are purely accounting values based on posted prices. The more meaningful figures are those on oil revenues, which are taken from Petroleum Press Service, August 1968.

5. The problem in tackling question 1 (a) and those under 1 (b) is that we are not certain what their precise intent is. I think that Annex I is substantially responsive to question 1 (a) and gives sufficient

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1/ We infer this in two ways - both imperfect: (a) Iranian wells are still the most productive in the world, on the average (see Table 11, Annex I); (b) Iran's reported average revenue per barrel (estimated at 83.5 cents in 1967) is near the average for the Middle East, and much lower than in Venezuela or Libya (where it is close to a dollar).

background to permit us to be very brief in our answers to the questions under 1 (b). However, if Mr. McNamara has already read Annex I there may be further points to his questions which we are missing. In the absence of any reference to Annex I in the questions, I am assuming that it has not already been read.

6. While the historical data and discussion in Annex I only carry through 1965, the basic historical situation presented there will only change marginally if updated (a project, incidentally, that is in progress). In the following paragraphs, we shall do some of this updating, while at the same time pointing up some of the more salient features of the world petroleum industry. We may return to some of these points in answering 1 (b) later on.

Demand Growth

7. For the postwar period as a whole, taken as 1955-1968 in order to omit the reconstruction period, world demand growth for petroleum averaged a phenomenal 6.9 percent per annum. The pace increased in the 1960's to 7.3 percent per annum (1960-1968). However, the rates of growth by major economic region varied widely from 3.5-4 percent per annum in North America to over 20 percent per annum in Japan, and almost 12 percent per annum in Western Europe. The growth rates by major regions are shown in Table 3.

Trade Growth

8. World imports of petroleum and petroleum products have been growing much faster than world demand, largely because demand growth has been fastest in areas that are both large consumers and heavily dependent on imports, i.e., Western Europe and Japan. Even in the U.S., with its large oil-producing industry, imports have been allowed to rise faster than production by permitting overland shipments from Mexico and Canada to enter ex quota. World import demand grew at 9.7 percent per annum in 1955-1968 and 10.8 percent per annum in 1960-1968.

9. Beginning in the late 1950's, the USSR has striven to regain its prewar position as an important supplier to Western Europe, and Canadian exports began to appear in the early 1960's and have continued to grow. Export volume growth for the LDC's has therefore been somewhat slower than world import growth but, as far as we can determine from rather imperfect data, not yet materially so, since Canada and the USSR combined still only account for roughly 8 percent of world exports. The effect of their growing exports had a displacement effect regionally, however; in the U.S. in the case of Canada and in Europe in the case of the USSR.

10. Within the global trade volume there was a significant shift in product composition. As stated in Annex I, in 1937 about one-third of total world imports were refined products (gasoline, etc.). By 1965 the

latter's share was only 25 percent and this trend has probably continued in view of the continued preference of importing countries to do their own processing.

11. World petroleum import growth has been distributed very unevenly among the major developing exporting countries, as illustrated by Table 4, which shows estimated relative shares of these countries in total world export trade. As already suggested in paragraphs 2 and 3 above, much of this variation is attributable to: (a) the appearance of new entrants in petroleum production, (b) the relative profitability of companies in various host countries, and (c) the political bargaining power of the host governments. The first factor, of course, tends to reduce the strength of the third, since it permits companies and importing governments to spread the security risks affecting their sources of supply.

12. We have noted that some new entrants (e.g., Abu Dhabi), secured reportedly better terms on profit sharing from sponsoring companies (the Japanese) but in the long run, their very existence will furnish a basis for the international companies to improve their end of the bargain, or at least avoid further concessions. The Japanese have already single-handedly played this game in the iron ore field with breathtaking success. The producing countries no doubt realize it and are trying to concert their positions via the Organization of Petroleum Exporting Countries (OPEC), of which Iran is an active member. But while all the OPEC countries are ostensibly and vocally in favor of "leveling up" the profit-splitting arrangements, we see no evidence that they are about to agree on fixed market shares for the future.

Industry Structure

13. In the opening paragraphs of Annex I we note that the dominance of the major companies has been declining since the 1950's in the international oil economy outside the U.S. and the USSR. In terms of crude production, the share controlled by these companies outside the U.S. declined from almost 90 percent in the late 1940's to around 75 percent in the mid-1960's. This trend has continued, the share of the eight major companies amounting to about 65 percent in 1968.

14. It is already evident that the geographical distribution of oil production has also been greatly diversified during the postwar period (see Table 4, for example). It seems clear that the international petroleum economy is dynamic in more respects than the aggregate growth rate and is not easy to characterize as a simple oligopoly.

15. I believe some of the foregoing remarks anticipate what we have to say in response to the questions under 1 (b) above. Following are additional comments.

Effect of Technical Qualities on Trade Flows

16. The technical qualities of various crudes have an influence on trade flows, but not a dominant or a precisely quantifiable one. To illustrate this, one may compare Tables 5, 6 and 7. Fuel oil has been experiencing the highest consumption growth rate globally and in Europe and Japan (Table 5). In spite of this Middle East crude, which in the aggregate is rich in the heavy fractions, lost ground in Europe but gained in Japan. This indicates that location (including, of course, the closing of the Suez Canal) and the fact that Japanese companies have become heavily involved in oil production in the Middle East are also important factors. Company nationality also helps explain the increasing share of African crudes in Europe. Canadian competition under the quota system and probably less than friendly company-government relations, probably explains the shift in Venezuela's marketing toward Europe as much as the technical quality of its crudes (which, however, are said to lend themselves well to blending with Middle East crudes for European refineries).

17. Sulfur content is another characteristic of crudes that is often mentioned as influencing demand, low sulfur content being desirable. Roughly speaking, African oils enjoy the lowest sulfur content and Iran is somewhat better off than other Middle East countries in this respect. On the other hand, African oils are afflicted by heavier wax content, which increases handling costs. However, in the end these characteristics are reflected in product costs - and their impediment to the marketability of any crude can be overcome if the refinery can get the crude cheaply enough in the first place and is confident enough of the supply to make the plant adjustments necessary.

Constraints of Government Policies on Trade Flows

18. We generally proceed on the assumption that in any consuming country there will be a tendency for oil produced abroad by companies that are nationals of that country to receive whatever favored treatment is possible. However, no one importing country provides a market for any exporting country's entire output and no major company markets its entire foreign output in the mother country. Hence company nationality is not sufficient by itself to account for trade patterns and flows in petroleum.

19. As far as government import policies are concerned, only one country has a fairly definite and publicly stated policy, i.e., the U.S., which has import quotas. These are described briefly in paragraph 5 of Annex I. Other major importing countries and areas either have no specific government policy on petroleum imports, or one that is pragmatic and unpublicized.

Shifts in Direction of Trade

20. Unfortunately, we do not have sufficient data readily at hand to show changes in the geographic marketing patterns of the major companies. Table 6 shows shifts in the geographic distribution of producing areas' exports between 1960 and 1968. Table 7 shows the changes that occurred in the shares of the various exporting areas in the imports of the major producing areas. It is possible to rationalize these changes in a general way in terms of oil qualities, the closing of the Suez Canal, the development of larger tankers, company nationality, the U.S. quota system, costs of production and importing countries' security desires. However, in the end there is no objective set of values or weights that can be applied to the array of reasons so as to yield a unique objective trade matrix corresponding to what has actually taken place historically. In forecasting exports from individual countries for medium term periods, we rely heavily on trend analysis and subjective judgments based on as much information as we can accumulate.

Joint Ownerships

21. It is our understanding that the relatively new joint-ownership concept is a device to permit governments of producing countries to exploit, independently of the companies, potential new or expanded markets in developing countries and Eastern Europe - the latter on the assumption that the USSR may not be able to cover fully the future growth in the import demand of its Warsaw Pact partners. Much, if not all, of this trade is expected to be on a government-to-government basis.

22. Table 8 shows the existing agreements of which we are aware and some of the principal terms.

Contractual Arrangements

23. The principal features of the contractual arrangements between companies and host countries are summarized in Table 4 of Annex I and discussed in paragraphs 9-11 of that paper.

Government and Bank Mission Oil Export Projections for Iran

24. According to EMA-3a, February 25, 1969, the Iranian Government projected oil export volume to grow at 16.4 percent per year between 1968 and 1972 while the Bank Mission assumed 8.6 percent per year.

25. Our own present projections of future growth in aggregate OECD net imports, in practice equivalent to global net trade growth (Annex I, page 11) is 7.5-9.0 percent per year. Annex I is now in the process of being updated and its projections reviewed but the review may not necessarily result in a substantial change in that estimate - much depends on what we conclude about the future of Alaskan oil. This trade volume

projection being a global one, however, it cannot be applied automatically to individual countries (certainly not, for example, to Venezuela - see paragraph 38, Annex I). However, we do not in fact know on what basis the Mission arrived at its projected growth rate for Iranian exports.

Negotiations between Iran and Companies

26. We do not have firsthand information on this subject. We understand that Iran is pressing the Consortium to agree to increase its offtake of Iranian oil by 17 percent in 1970 over 1969. In 1965, Iran asked for a 17.5 percent increase during 1966 but the increase did not materialize. It is possible that Iran will settle for a continuation of its average growth rate in the 1960's (around 13 percent per year) or possibly less.

AJMacone/ACHuang/hl

Table I: PETROLEUM: DISTRIBUTION OF WORLD PRODUCTION, MARKETINGS AND RESERVES, AND PRODUCTION GROWTH RATES BY COUNTRIES IN SELECTED YEARS

I: Distribution of Production and Reserves by Selected Countries or Companies, and Production Growth Rates, Selected Periods

Area/Country	1968 BP	CFP	Esso	Gulf	Mobil	Shell	Stancal	Texaco	8 Companies	Other	Total 1/	Proved Reserves end-1967	Projections 1975 8/	Production Growth Rate 1955-68	1960-68
	Million Metric Tons 2/													% per year	
North America															
United States	0.6	-	46.6	29.5	17.6	29.3	27.9	41.7	193.2	259.7	452.9	6,644.5	550.0	2.5	3.3
Canada	0.8	0.2	8.5	3.9	3.6	3.3	2.7	6.5	29.6	27.4	57.0	1,204.5	100.0	9.7	10.1
Total	1.3	0.2	55.1	33.4	21.2	32.7	30.6	48.3	222.8	287.1	509.9	7,849.0	650.0	3.0	3.9
Middle East															
Saudi Arabia	-	-	42.3	-	14.1	-	42.3	42.3	141.0	0.1	141.1	11,645.0	-	8.9	10.8
Kuwait	51.5	-	-	70.6	-	-	-	-	122.1	-	122.1	9,590.0	-	6.5	5.2
Iran	50.8	7.7	9.3	8.8	9.5	17.8	8.3	9.3	121.3	20.2	141.5	6,850.0	-	18.2	13.2
Iraq	17.5	17.5	8.8	-	8.8	17.5	-	-	70.1	3.9	74.0	4,795.0	-	6.5	5.7
Abu Dhabi	9.5	6.6	1.8	-	1.8	3.6	-	-	23.3	.7	24.0	2,055.0	-	3/	3/
Qatar	2.2	2.2	1.1	-	1.1	9.3	-	-	15.8	.4	16.2	548.0	-	8.8	8.9
Bahrain	-	-	-	-	-	-	1.8	1.8	3.5	-	3.5	34.3	-	6.7	6.0
Other	10.3	1.2	-	7.0	-	-	-	-	18.5	16.8	35.3	3,182.5	-	22.0	19.2
Total	141.8	35.2	63.2	86.3	35.2	48.2	52.3	53.3	515.5	42.2	557.7	38,699.8	-	10.2	9.9
Latin America															
Venezuela	-	-	88.3	10.6	6.0	54.3	3.2	10.4	172.8	16.7	189.5	3,425.0	-	4.1	3.0
Colombia	0.3	-	1.2	-	0.5	1.3	1.7	2.2	7.1	1.8	8.9	274.0	-	3.8	1.5
Other	2.4	-	1.5	1.5	-	2.8	-	6.4	14.6	50.5	65.1	1,078.9	-	8.0	6.8
Total	2.7	-	90.9	12.1	6.7	58.3	4.9	19.0	194.4	69.1	263.5	4,777.9	-	4.9	3.8
Africa															
Libya	7.4	-	3.0	-	7.5	-	5.9	5.9	29.7	96.3	126.0	2,740.0	-	3/	3/
Algeria	-	10.3	-	-	0.3	3.0	-	-	13.5	29.5	43.0	1,370.0	-	4/	22.0
Nigeria	1.1	-	-	4.9	-	1.1	-	-	7.0	-	7.0	1,644.0	-	4/	29.0
Other	-	-	-	-	0.05	2.8	-	-	2.8	17.2	20.0	167.4	-	4/	21.0
Total	8.5	10.3	3.0	4.9	7.8	6.8	5.9	5.9	53.0	143.0	196.0	5,921.4	-	-	39.0
South and South-East Asia															
Indonesia	-	-	0.9	-	0.9	-	11.1	11.1	24.1	3.2	27.3	1,370.0	-	6.5	3.6
Other	-	-	-	-	-	6.2	-	-	6.2	8.9	15.1	304.8	-	6.8	9.3
Total	-	-	0.9	-	0.9	6.2	11.1	11.1	30.3	12.1	42.4	1,674.8	-	6.6	5.8
Western Europe 5/	0.8	-	3.4	0.4	1.9	3.8	.03	.03	9.6	13.3	22.9	450.2	25.0	7.0	5.1
Total	0.8	-	3.4	0.4	1.9	3.8	.03	.03	9.6	13.3	22.9	450.2	25.0	7.0	5.1
World Total 6/	154.4	45.6	216.7	137.0	73.6	156.0	104.7	137.6	1,025.6	566.8	1,592.4	59,373.1	-	6.8	7.5

II: Marketings of Crude Oil and Refined Products of Major Companies by Countries and Areas, 1968

(Total Company Sales in Million Metric Tons) 2/

Area/Country	BP	CFP	Esso	Gulf	Mobil	Shell	Stancal 7/	Texaco
United States			45.5	38.0	42.6	70.0		
Canada	9.5		17.1	8.9			47.3	
Latin America			53.7	-		19.3		73.2
Other Western Hemisphere	-		-	3.9				
Total Western Hemisphere	9.5	-	116.3	50.8	-	89.3	47.3	73.2
United Kingdom	15.2				47.9			
EEC	36.0					82.1		
Rest of Europe	15.8							
Asia	11.8		106.8	16.6			45.0	51.3
Australia and New Zealand	3.7					38.6		
Africa and Middle East	5.5							
Total Eastern Hemisphere	88.0	-	106.8	16.6	-	120.7	45.0	51.3
World Total 10/	97.6	51.6 9/	223.2	67.4	90.5	210.0	92.1	124.6

1/ Excluding natural gas liquids.

2/ Totals may not agree due to rounding.

3/ Began production after 1960.

4/ Began production after 1955.

5/ Includes Turkey.

6/ Excluding centrally planned countries.

7/ For year 1967.

8/ See paragraph 2 of covering memorandum.

9/ Breakdown not available.

10/ These totals not reconciled with production totals due to non-comparability of different statistical sources. Where marketings exceed production, part of discrepancy due to purchased crude.

Sources: Petroleum Press Service; Company Annual Reports; World Petroleum Report, V.14, 1968; 20th Century Petroleum Statistics, 1968.

Table 2: IRANIAN CRUDE OIL PRODUCTION - 1959-1969

	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969
Production (Millions of Barrels)	338.8	390.8	430.9	482.6	538.6	618.6	688.2	771.3	947.8	1,034.8 1/	1,173.0 2/
Production (Million Metric Tons)	46.4	52.6	59.4	66.0	73.1	84.8	94.8	105.1	129.3	141.5	160.0 2/
Nominal f.o.b. Value of Oil Exports 3/ (Million Dollars)	n.a.	n.a.	n.a.	902.1	942.5	999.6	1,138.6	1,298.6	1,547.0	n.a.	n.a.
Government Revenues (Million Dollars)	263	285	301	334	398	475	534	607	746	902 4/	n.a.

1/ Estimated.

2/ Annual rate based on first seven months.

3/ Accounting value based on posted prices as recorded in the balance of payments.

4/ Bank Mission estimate.

Sources: 20th Century Petroleum Statistics, 1968; Petroleum Press Service, August 1968, September 1969; IBRD Report EMA-3a, Table 7; British Petroleum Statistical Review of the World Oil Industry, 1968.

Table 3: POSTWAR GROWTH TRENDS IN PETROLEUM CONSUMPTION BY MAJOR CONSUMING AREAS

(Percent per annum)

	1955-1968	1960-1968
North America	3.6	3.9
Western Europe	11.9	11.8
Japan	22.4	21.1
Other	7.1	6.5
Total World (excluding Bloc)	6.9	7.3

Source: British Petroleum Company Ltd.

Table 4: ESTIMATED SHARES OF SELECTED DEVELOPING AREAS AND COUNTRIES IN WORLD (EX BLOC) OIL EXPORTS

(Percent)

	1950	1960	1968
Middle East	42.9	55.3	54.0
Iran	16.7	11.9	14.7
Iraq	3.1	10.8	7.7
Kuwait	8.9	18.6	12.7
Saudi Arabia	14.1	14.0	14.7
Others	0.1		
Africa	1.6	2.1	18.1
Algeria		1.3	4.0
Libya			11.6
Nigeria		0.1	0.6
Others		0.7	1.9
Western Hemisphere	42.9	34.0	21.1
Venezuela	33.5	28.1	16.5
Others	9.4	5.9	4.6

Source: Regional and World Total Exports: British Petroleum Company Ltd.
Country exports: estimated by adjusting British Petroleum Production figures for the respective countries.

Table 5: GROWTH RATES OF DEMAND FOR SELECTED PETROLEUM PRODUCTS IN SELECTED REGIONS 1960-1967

(Percent per annum)

	Gasoline including Jet Fuel	Diesel Oil including Kerosene	Fuel Oil
United States	3.8	3.7	2.4
Canada	5.6	3.2	7.2
Europe	9.9	9.0	14.2
Japan	17.0	21.9	20.9
Total of above	5.2	6.9	9.4

Source: OECD, Basic Statistics of Energy, 1951-1965 and 1953-1967.

Table 6: SHARES OF MAJOR CONSUMING REGIONS IN EXPORTS OF PETROLEUM EXPORTING AREAS

(Percent)

Exporters \ Importers	United States		Western Europe		Japan		Other Importers		World	
	1960	1968	1960	1968	1960	1968	1960	1968	1960	1968
United States	-	-	21.1	22.2	4.2	19.5	74.7	58.3	100.0	100.0
Canada	100.0	100.0	-	-	-	-	-	-	100.0	100.0
Latin America	46.6	52.2	21.1	22.2	-	2.2	32.3	23.4	100.0	100.0
Middle East	7.4	2.5	58.1	48.7	9.3	25.5	25.2	23.3	100.0	100.0
Africa	-	4.2	100.0	91.6	-	0.1	-	4.1	100.0	100.0
South-East Asia	19.0	16.3	9.5	3.5	20.5	55.8	51.0	24.4	100.0	100.0
Soviet Bloc	-	-	73.9	81.3	4.4	4.0	21.7	14.7	100.0	100.0
Others	-	25.3	-	1.1	-	1.1	100.0	72.5	100.0	100.0

- means nil or negligible.

Source: British Petroleum Company Ltd.

Table 7: SHARES OF PETROLEUM EXPORTING AREAS IN THE IMPORTS OF MAJOR CONSUMING MARKETS, 1960 AND 1968

Exporters \ Importers	United States		W. Europe		Japan	
	1960	1968	1960	1968	1960	1968
	(Percentage of total imports)					
United States	-	-	1.0	0.4	1.5	1.1
Canada	6.1	16.0	-	-	-	-
Latin America	71.3	63.6	15.4	7.8	-	2.6
Middle East	18.3	8.8	68.2	49.4	78.9	86.6
Africa	-	5.3	5.7	33.4	-	0.2
Southeast Asia	4.3	2.4	1.0	0.1	15.9	7.8
Soviet Bloc	-	-	8.7	8.9	3.7	1.5
Others	-	3.9	-	-	-	0.2
World	100.0	100.0	100.0	100.0	100.0	100.0

- means nil or negligible.

Source: British Petroleum Company Ltd.

Table 8: JOINT VENTURE AGREEMENTS IN MIDDLE EAST

	Iran	Saudi Arabia	Kuwait
Agreement	1965 six offshore agreements NIOC/ foreign group	Petromin/ERAP/Tenneco	KNPC/Hispanoil
Type of Agreement	Joint structure agreement	Exploration concession agreement and joint venture development contract	Concession agreement for joint venture
Government participation	50% except exploration	40% after grant exploitation concession, with 50% voting rights	KNPC (60% owned by Kuwait Govt.) 51% after commercial discovery
Payments ($ Million)	Ranging 25-59 initial, total six groups 190	0.5 initial. 1 on grant of exploitation concession. 4 when production 70 000 b/d	2.8 when output reaches 100 000, 200 000, 300 000, 400 000 and 500 000 b/d. Hispanoil finances exploration prior to discovery, KNPC then reimburses its share
Royalty	None	15% if annual average below 60 000 b/d. 17% if 60-80 000 b/d. 20% above. Posted price, expensed. $1.5 million minimum after 2 years	12½% posted price, expensed
Tax	Most favored company rate. (Effectively 50%) Minimum payment 12½% posted price	Income tax 40% (or according to future legislation) on profit related to posted price. ½ c/b marketing allowance	50% based on posted price
Petroleum pricing	Posted price. Discounts permitted if approved by NIOC	Board determines posted and offtake prices. Petromin has right of approval on ERAP's sales price for Petromin crude	Posted price comparable to other Arabian Gulf crudes, Kuwait Government approval

Table 8 (Continued)

	Iran	Saudi Arabia	Kuwait
Crude offtake	Each party lifts 50% of production. Each may purchase other's unlifted share at a price halfway between posted price and unit production cost	Government may take 40% production or have ERAP market for export at specified commission schedule related to sales price. Government may buy 10% of production at special price	-
Special provisions	-	Saudi tanker preference	Spanish Government reserves up to 25% of Spanish crude and products imports for Hispanoil share of crude produced plus 20 000 b/d maximum of KNPC share
Period and extensions	25 years from commercial production - 3 of 5 years each	2 year exploration licence renewable 3 years. 30 year exploitation lease	35 years - 5 years
Area (square miles) and relinquishments	Various, total of the six 13 600 - 25% in 5 years, 50% in 10 years; to producing areas only in 12 years	10 300 - 20% of unexploited area after 3 years and every 5 years thereafter	4 100 - 20% of unexploited area in 3 years after discovery, 20% every 5 years thereafter
Exploration obligations	Total cumulative obligation of foreign partners (including exploration) 12 years $129 million	$5 million in 2 years. In 3 year extension minimum drilling	Minimum $2 120 000 expenditure per year and minimum drilling 8 years
Natural Gas	To Government at cost	Subject to negotiation. 12½% royalty	Company use subject to Government approval, surplus to Government free

Source: Petroleum Press Service, March 1969.

Table 9: WORLD PETROLEUM PRODUCTION 1955-68

(million tons)

Country/Area	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968
North America														
United States														
Crude Oil	329.5	347.1	347.1	333.2	350.3	350.3	356.7	364.1	374.5	379.2	387.6	412.0	437.5	452.9
Natural Gas Liquids	32.7	34.0	34.3	29.2	31.8	33.8	35.8	36.9	39.5	41.7	43.6	46.1	50.5	54.3
Canada	17.1	22.7	24.4	22.9	25.4	26.4	31.3	35.7	38.2	41.4	45.0	49.4	54.1	57.0
Mexico	12.5	12.6	12.2	13.2	13.7	14.9	16.4	17.1	18.3	18.6	18.8	19.1	20.2	21.2
Total North America	391.8	416.4	418.0	398.5	412.2	425.4	440.2	453.8	470.5	480.9	495.0	526.6	562.3	585.4
Caribbean														
Colombia	5.5	6.3	6.4	6.6	7.6	7.9	7.7	7.3	8.2	8.8	10.4	10.2	9.4	8.9
Trinidad	3.5	4.1	4.8	5.3	5.7	6.1	6.6	7.0	6.9	7.1	7.0	7.9	9.3	9.6
Venezuela	112.6	128.0	144.6	134.9	143.5	150.1	151.1	166.1	170.4	177.4	182.1	176.8	184.9	189.5
Total Caribbean Area	121.6	138.4	155.8	146.8	156.8	164.1	165.8	180.4	185.5	193.3	199.5	194.9	203.6	208.0
South America														
Argentina	4.3	4.9	4.8	5.1	6.4	9.1	12.0	14.0	13.9	14.7	14.1	15.0	15.6	17.1
Brazil	0.3	0.5	1.3	2.6	3.3	4.1	4.8	4.6	5.1	4.6	4.7	5.8	7.1	8.9
Others	3.4	3.8	4.0	4.1	4.0	4.3	4.5	5.0	5.3	5.6	5.6	5.8	6.6	8.3
Total South America	8.0	9.2	10.1	11.8	13.7	17.5	21.3	23.6	24.3	24.9	24.4	26.6	29.3	34.3
Total Western Hemisphere	521.4	564.0	583.9	557.1	591.7	607.0	627.3	657.8	680.3	699.1	718.9	748.1	795.2	827.7
Western Europe														
Austria	3.6	3.4	3.1	2.8	2.4	2.4	2.4	2.3	2.6	2.6	2.8	2.7	2.7	2.7
France	0.9	1.2	1.4	1.4	1.6	2.0	2.2	2.4	2.5	2.8	3.0	2.9	2.8	2.7
Germany	3.1	3.5	3.9	4.5	5.1	5.5	6.2	6.8	7.4	7.7	7.9	7.9	7.9	8.0
Others	1.9	2.5	3.8	4.3	4.8	5.4	6.0	6.2	6.6	7.8	8.4	8.6	9.4	9.5
Total Western Europe	9.5	10.6	12.2	13.0	13.9	15.3	16.8	17.7	19.1	20.9	22.1	22.1	22.8	22.9
Middle East														
Iran	16.1	26.4	35.6	41.0	46.4	52.6	59.4	66.0	73.1	84.8	94.8	105.1	129.3	141.5
Iraq	32.8	30.7	21.7	35.8	41.8	47.5	49.0	49.2	56.7	61.6	64.4	68.0	60.1	74.0
Kuwait	53.9	54.1	56.4	70.2	69.5	81.9	82.7	92.2	97.2	106.7	109.0	114.4	115.2	122.1
Neutral Zone	1.3	1.7	3.4	4.3	6.1	7.3	9.5	13.0	16.7	19.4	19.1	22.3	21.7	22.1
Qatar	5.4	5.8	6.5	8.2	7.9	8.2	8.3	8.8	9.0	10.2	11.0	13.8	15.4	16.2
Saudi Arabia	46.8	47.9	48.2	50.1	54.2	62.1	69.2	75.8	80.5	86.4	100.8	119.4	129.2	141.1
Others	1.5	1.5	1.6	2.2	2.1	2.2	2.2	2.2	2.4	2.4	2.8	3.3	6.5	16.7
Abu Dhabi	-	-	-	-	-	-	-	0.8	2.6	9.0	13.6	17.3	18.3	24.0
Total Middle East	157.8	168.1	173.4	211.6	228.0	261.8	280.3	308.0	338.3	380.5	415.5	463.6	495.7	557.7
Africa														
Algeria (including Sahara)	0.1	-	-	0.4	1.2	8.6	15.8	20.7	23.9	26.5	26.5	33.8	39.1	43.0
Libya	-	-	-	-	-	-	0.9	8.7	22.4	41.4	58.7	72.3	84.3	126.0
Other North Africa	1.9	1.8	2.4	3.3	3.3	3.4	3.9	4.8	5.8	6.6	6.6	7.0	5.6	14.8
Nigeria	-	-	-	0.3	0.5	0.9	2.8	3.5	3.8	6.0	13.7	20.7	16.2	6.9
Other West Africa	-	-	0.2	0.5	0.8	0.9	1.0	1.5	1.8	2.4	1.8	2.3	4.1	5.2
Total Africa	2.0	1.8	2.6	4.5	5.8	13.8	24.4	39.2	57.7	82.9	107.3	136.1	152.3	195.9
South-East Asia														
Indonesia	12.1	13.1	15.8	16.7	19.1	20.6	21.4	23.1	22.5	22.3	23.8	23.5	25.5	27.3
Other South-East Asia	5.2	5.6	5.5	5.2	5.4	5.6	4.2	4.0	4.0	3.7	3.9	4.7	5.6	6.2
Total South-East Asia	17.3	18.7	21.3	21.9	24.5	25.2	25.6	27.1	26.5	27.0	27.7	28.2	31.1	33.5
U.S.S.R.	69.6	82.5	96.8	113.2	129.5	147.9	166.0	186.0	206.1	223.6	243.0	265.1	288.0	309.0
Eastern Europe & Mainland China	13.6	13.9	14.2	15.3	17.2	19.3	20.0	21.8	22.4	24.2	25.2	26.7	27.0	29.7
Other Eastern Hemisphere	1.2	1.2	1.4	1.6	1.7	1.8	2.0	3.1	3.5	4.2	5.1	7.0	8.2	8.9
Total Eastern Hemisphere	271.0	296.8	321.9	381.1	420.6	485.1	535.1	602.9	673.6	763.3	845.9	948.8	1,025.1	1,157.6
WORLD (excluding USSR, E.Europe and Mainland China)	709.2	764.4	794.8	809.7	865.6	924.9	976.4	1,052.9	1,125.4	1,214.6	1,296.6	1,405.1	1,505.3	1,646.6
WORLD	792.4	860.8	905.8	938.2	1,012.3	1,092.1	1,162.4	1,260.7	1,353.9	1,462.4	1,564.8	1,696.9	1,820.3	1,985.3

Source: Statistical Review of the World Oil Industry, 1965 and 1968, op. cit.

Table 54: WORLD PETROLEUM CONSUMPTION 1955-68

(million tons)

Country/Area	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968
U.S.A.	409	426	427	443	460	473	478	498	513	527	549	576	596	636
Canada	30	35	36	38	41	43	44	46	47	53	57	61	62	64
Other Western Hemisphere	61	65	72	76	79	86	88	91	93	98	103	107	111	118
Total Western Hemisphere	500	526	535	557	580	602	610	635	653	678	709	744	769	818
Benelux	12	15	15	16	17	21	24	28	32	38	43	45	46	50
France	20	23	23	25	25	28	31	36	42	48	54	58	66	73
Germany	13	16	17	21	27	35	41	50	60	69	80	89	94	104
Italy	12	14	15	17	19	24	29	35	40	48	52	59	64	71
United Kingdom	29	31	30	37	43	50	53	57	62	68	75	79	83	87
Scandinavia	14	16	15	17	19	21	22	25	28	31	34	39	39	42
Others	15	18	19	20	22	24	27	31	38	43	49	54	62	68
Total Western Europe	115	133	134	153	172	203	227	262	302	345	387	423	454	495
Japan	10	13	16	17	23	30	41	49	63	75	90	99	118	139
Australia	9	10	10	11	12	13	14	14	16	18	20	22	23	26
USSR, E. Eastern and Mainland China	81	93	106	120	132	144	156	175	193	206	221	239	260	283
Other Eastern Hemisphere	49	56	62	64	72	78	86	91	97	103	112	122	140	149
Total Eastern Hemisphere	264	305	328	365	411	468	524	591	671	747	830	903	995	1,092
World (excluding the USSR, E. Europe and Mainland China)	683	738	757	802	859	926	978	1,051	1,131	1,219	1,318	1,410	1,504	1,627
TOTAL WORLD	764	831	863	922	991	1,070	1,134	1,226	1,324	1,425	1,539	1,649	1,764	1,910

Source: Statistical Review of the World Oil Industry, 1965 and 1968, London.
The British Petroleum Co. Ltd.

FORM No. 57

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

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: October 24, 1969

FROM: Irving S. Friedman ISF

OCT 27 1969
(Returned - 2 pm)

SUBJECT: Bank/Fund Collaboration on Missions and Reports

As requested I discussed with Mr. Southard the question of closer collaboration with respect to Bank economic missions and IMF consultation missions, particularly the possibility of simultaneous missions. I reported on this to the Senior Staff Meeting on Tuesday last.

Very briefly I informed Mr. Southard of our plans for economic missions, and of the enlarged scope of the economic country reports. I gave him copies of our most recent mission schedule and the operational memorandum on economic missions and reports. I also commented on the Fund's participation in the meetings of the Bank Economic Committee, which hitherto has reviewed the country economic reports and the economic policy papers, and now would be receiving the country program papers. Mr. Southard provided me with a six-month schedule of Fund missions, which is essentially modelled on the six-month schedule we had previously used in the Bank before the introduction of the new annual schedules.

Mr. Southard indicated that he was starting discussions among Fund staff on what closer collaboration might be achieved with the Bank on economic missions and reports. He noted that hitherto the initiative for including a Bank man on a Fund mission or a Fund man on a Bank mission had always been taken by the Bank. He had raised the question with the Fund staff as to whether such initiatives might also be taken by the Fund. He queried whether there were to be a large number of countries with Bank missions of the size and responsibility of the Indonesia mission. Mr. Southard felt that this was very important as the Fund might wish to consider how it should relate to such large missions. I told him that I did not think it was to be a general practice to have such large missions, but would check out this point. (After checking with Mr. Knapp I was able to inform Mr. Southard that we were not planning in the forseeable future other missions along the lines of the Indonesia mission.)

Mr. Southard subsequently informed me that the preliminary talks with the Fund staff had indicated that the Fund Area Department people felt that there was a great deal of collaboration going on between the Bank and the Fund Area Departments, thus confirming the previously expressed attitudes by the Bank's Area Department people. He noted that up to six years ago this collaboration did not exist, but that it had been built up during that period to a close informal working relationship and which he felt had not been reflected in the Pearson Commission Report.

As to simultaneous missions, the Fund staff's preliminary reaction was that because their missions were much shorter in time both in the field (two weeks) and in preparation of the consultation report after returning from the field (three to four weeks) it might be difficult to have simultaneous missions. However, we discussed the possibility of examining whether

President has seen

simultaneous missions or closer collaboration in the field might be possible in cases of the mutually most important countries.

We also discussed briefly the possibility of a joint Bank/Fund memorandum to be sent to both Boards simultaneously, which had been suggested at the Senior Staff Meeting on Tuesday. Mr. Southard thought that this was quite possible but for the moment their plans were to make considered proposals to Mr. Schweitzer for discussions to be held with the Bank staff.

In the meantime, I have asked Mr. Kamarck to have discussions with the Bank Area Department people and others and collate their views on this subject. I hope to be able to come up shortly with a memorandum to you making recommendations in this field.

Incidentally, I also checked out with Mr. Southard the distribution of IMF consultation papers. Part I of their papers, which contains staff recommendations and the record of their conversations with governments, are not distributed externally. Part II of the papers, which contains background information, are distributed on request to countries and international agencies. However, they do not regard these papers as serving the U.N. family in the sense that we do in the Bank, and not many requests are received for these Part II papers.

cc: President's Council
Mr. Kamarck

FORM No. 57 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. J. Burke Knapp

DATE: October 21 1969

FROM: Irving S. Friedman

SUBJECT: Composition of Economic Missions

I would like to comment very briefly on the memorandum of October 16 sent to you by Mr. Demuth on the composition of economic missions. As you know I was having rather extensive discussions with the Area, Projects and Economics Departments in April, May and June, as to the scope and composition of economic missions as reflected in the new economic memorandum on this subject.

The point made by Warren Baum was made to me last spring and is, of course, a very real problem. The Projects Department Directors were quite emphatic in pointing out that we had not done sector studies in most countries in the new areas of investment, but also had not done sector studies in a number of the traditional sector areas in many countries. However, this is part of a broader subject of staff availability for the kind of work we have undertaken to do, which, as you know, I believe we ought to be doing.

As for relations with the UN agencies I do not have any observations as my knowledge is very limited, except for those with the IMF.

I would be happy to join a discussion on the staffing of economic missions, if you wish to have such a discussion or could continue my own discussions which I have been having, as you prefer.

ISF

cc: Mr. Demuth

Mr. Knapp

October 16, 1969

Richard H. Demuth

Composition of Economic Missions

As you know, at Mr. McNamara's request I obtained the agreement of FAO, ILO, WHO, Unesco and the UNDP to cooperate in our expanded program of economic missions. Mr. McNamara referred in his Annual Meeting speech to the plan for an expanded program and to our intention to call upon the other specialized agencies, and he will, I believe, also touch on this topic in his ECOSOC address. The program is, as you know, a key element in trying to bring about more effective coordination of development assistance at the country level.

There are, however, two immediate problems with respect to the implementation of this program: (a) how to assure that the decision to broaden the scope of the missions' inquiry and to take advantage of the expertise of the UNDP and the other specialized agencies is reflected in the composition of the missions; and (b) where to assign responsibility for arranging for the appropriate kind of participation by UNDP and the agencies.

(a) If you look at the most recent "Twelve-Month Schedules of Economic, Up-Dating and Special Missions," dated October 1, 1969 (EC/O/69-97), you will see that most of the missions listed, including those to be sent to "A" countries, are designed to deal only with those sectors which we have traditionally examined, to the extent that they will be concerned with sectors at all. Some of the missions will not engage in any sector examination; others will do so only to a limited extent. The non-traditional sectors -- urban planning, water supply, industry, employment, public administration etc. -- are in most cases not indicated areas of inquiry. Composed as shown, most of the missions could therefore not report in detail on social as well as economic progress. Neither could they report comprehensively on priorities for pre-investment work. Only one of the missions is in fact designed to draft an across-the-board program of pre-investment work, although some of the sector specialists on the missions, as well as the special sector missions to be organized by the Projects Department, will be considering pre-investment needs in particular sectors.

I appreciate that the plans for the missions to be sent out during the next 12 months were formulated some time ago, before the intention to expand the mission program was announced and the cooperation of the other agencies sought. I also realize that, even with the assistance of the other agencies, it would take some years to develop a comprehensive picture of the economy of each of the developing countries. Nevertheless, I believe that it would be desirable to emphasize to staff

President has seen

members concerned with the composition of the economic missions - the Area Departments in particular - the importance of regularly making provision for a much broader investigation than has been conducted in the past and of taking full advantage of the information and expertise available in the cooperating agencies.

I do not believe that that objective can be accomplished merely by adding an appropriate provision to the forthcoming Operational Memorandum. That should be done, but I suggest that, in addition, at one of your weekly meetings with the Area Department heads, to which the Area Chief Economists and perhaps representatives of other interested Departments might be invited, you should discuss the program, emphasize its importance, and clearly assign the responsibility for carrying it out to the Area Directors and their Chief Economists.

Warren Baum, to whom I showed an earlier draft of this memorandum, says that there is an even more serious problem than the one of communication. The present staffing program of the Projects Department was based on a forecast of even less mission activity than is indicated in the 12-month schedule referred to above. If the result of the steps I have recommended is to broaden the area of investigation of the economic missions in an effort to conform practice to announced policy, he believes that the Projects Department will not have the staff necessary to enable it to handle the increased activity, given its operational load. You may wish to discuss this problem with Mr. McNamara.

(b) There are two stages for which we must make provision in arranging for assistance from the UNDP and the cooperating agencies. First, we have undertaken to give them early notice of the mission schedules so that they can inform their field missions and consider well in advance whether they have any information which might be useful to us or anyone who could be detailed to the mission should they be requested to provide an expert. This can be done by sending them regularly a copy of the 12-month mission schedule. Second, we must indicate at as early a date as possible the type of assistance we would like each agency to provide for a given mission. This might, but need not, involve detailing an expert to serve on the mission; it might require simply briefing the mission or providing some information. I realize that once the agencies receive the mission schedule, it is likely that one or another of them will volunteer assistance, and that sometimes we will have the problem of rejecting the offer. However, as I understand it, Mr. McNamara does want to involve the other agencies in the mission program to the fullest extent consistent with maintaining the high quality and a reasonable speed of production of the mission report. This is likely to complicate the life of the Area and Projects Departments for a time, but I think it has to be done. The involvement of the other agencies will not, of course, extend to clearance of the mission reports. The comments of the agen... will be invited but the Bank will have sole responsibility for the re...[1]

The Secretary of the Economic Committee routinely sends the schedule of economic missions to the regional banks. It would be logical to have him send the schedule to the UNDP and the four other agencies as well. As for the problem of communicating with the agencies with respect to the requirements for assistance to individual missions, there are already established procedures in the respective Projects Departments for dealing with FAO and Unesco through the cooperative programs. I would suggest, therefore, that these Departments be responsible for negotiating with these two agencies. I also suggest that someone in the Office of the Director, Projects, be assigned responsibility for taking parallel action with respect to WHO and ILO. The role of the UNDP Resident Representatives has already been sketched in the correspondence between Mr. McNamara and Paul Hoffman. I would suggest that the letter from the Secretary of the Economic Committee transmitting the mission schedules state that some time in advance of the arrival of each mission the mission chief will communicate directly with the Resident Representative concerned, to suggest the kind of information (e.g., an inventory of on-going and projected pre-investment work) which the mission would hope to be able to obtain from him when it arrives. The Area Departments should be instructed to see that these letters go out in ample time to the Resident Representatives.

Finally, I would suggest that, whatever decisions concerning the assignment of responsibility on these matters are taken, they be communicated to Bank staff members through an appropriate modification of the Operational Memorandum.

I should be glad to discuss these proposals with you at your convenience. Perhaps an even better plan would be for you to meet with Messrs. Aldewereld, Friedman, Adler, Kamarck, Baum and me to discuss this memorandum.

1/ The practice of giving participating agencies an opportunity to comment on mission reports was invariably followed with respect to general survey mission reports and the reports of a number of other missions (e.g., Jamaica family planning) where we sought the cooperation of other agencies. However, Warren Baum says that when FAO and Unesco staff are associated with Bank economic missions under the cooperative programs, the two agencies have not been given an opportunity to comment on the mission reports. The Projects Department staff is of the opinion that it will slow and complicate the work of the missions if agency reports are regularly solicited. But I do not see how we can ask the agencies to provide us with personnel or information and yet decline to give them an opportunity to review the reports to which they have thus contributed and which we hope will be a guide for their own programs.

cc: Messrs. Aldewereld, Friedman, Adler, Kamarck and Baum

...oskey/RHDemuth:tsb

Mr. Robert S. McNamara October 23, 1969

Irving S. Friedman

Country Economic Reports

You will recall that you discussed with me the question of trying to get our Country Economic Reports on a more even and regular basis, and pointed to the problem of bunching which now exists.

I have asked the Acting Secretary of our Economic Committee to give me a summary of the situation, and I attach his report.

We are taking steps to ensure that fiscal '70 is a transitional year, and that by fiscal '71 the pattern should become much closer to that which might be sustainable over the years.

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

OFFICE MEMORANDUM

TO: Mr. Irving S. Friedman

DATE: October 20, 1969

FROM: J. Chaffey

OCT 20 1969

SUBJECT: Economic Reports

1. You asked for my comments on whether the latest schedules of Missions and Reports suggested there would be an uneven flow of Reports, bearing in mind the classification of countries and thus the desirability of producing, for example, annual Reports every twelve months precisely.

Annual Countries

2. In FY70, there should be a Report scheduled on every annual country. But Reports are not scheduled for Uganda (Report scheduled for 10/70), Thailand (7/70), Turkey (7/70), UAR (8/70) and Argentina (11/70). On the basis only of the lapse of time between the scheduled Reports and the last Reports, it might be said that these countries were being phased in and that the slippage was not serious. I believe, however, that Programming and Budgeting have discussed these individual cases in some detail with the Area Departments (I have copies of some of the relevant correspondence).

3. The average length of time that will elapse between the last Report and the FY70 or currently scheduled one is:

Eastern Africa	2 years 0 months	(6 countries)
Western Africa	1 year 4 months	(3 countries)
East Asia & Pacific	1 year 2 months	(6 countries)
South Asia	1 year 0 months	(5 countries)
Europe, Middle East and North Africa	1 year 3 months	(5 countries excluding Spain)
Western Hemisphere	1 year 4 months	(5 countries excluding Peru)

The figures above suggest a need for tightening up the scheduling in some Area Departments but this does not take into account the ad hoc problems. The schedules for FY71 will indicate the improvements to be expected and we should be able to see what the first six months of FY71 will yield from the schedules published at the end of 1969.

Biennial Countries

4. The schedules show that Reports on all the biennnial countries for which FY70 Reports are due or overdue will be issued. For the Area Departments except Western Hemisphere (and excluding Algeria and Guinea) the Reports on average will appear 1 year 9 months after the last Reports (Guinea 3 years 1 month). In the Western Hemisphere, a number of countries are overdue for Reports (i.e. the last Report was issued over two years ago) and these will all be picked up during FY70. The Reports for Bolivia and Nicaragua will be issued 1 year 1 month and 1 year 4 months respectively after the last Reports. No Report is scheduled for El Salvador (last Report

7/66).

Triennial Countries

5. Reports on all triennial countries for which Reports are due or overdue during FY70, are scheduled. There are, however, several inconsistencies in the length of time that is scheduled to elapse since the last Report and the Report in FY70. It varies from CAR 1 year only, Sierra Leone and Trinidad and Tobago 1 year 2 months, and Upper Volta 1 year 4 months to over three years in the cases of Swaziland, Mali and Iceland. For Western Africa, as a whole, the average time span is only 1 year 11 months.

6. To sum up, I think that FY70 is the year during which a major effort is being made to establish the pattern of one, two and three year Reports. There does, however, seem to be a tendency (the reasons for which I have not explored) for biennial and triennial Reports to be coming forward sooner than they might.

Economic Committee Secretariat
Secretary's Department

FORM No. 58 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: October 23 1969

FROM: Irving S. Friedman

SUBJECT: Coffee and Tea

In view of recent developments in coffee and tea I have asked the Commodities Division to prepare brief notes on the current position and outlook. I believe you will be interested in seeing the attached two memoranda.

In essence, it indicates that the recent increase in coffee prices may well prove to be temporary because they reflect weather conditions rather than any cyclical changes. On the other hand, the outlook for tea prices looks poor.

ISF

Att:

OFFICE MEMORANDUM

TO: Mr. Andrew M. Kamarck DATE: October 17, 1969

FROM: Shamsher Singh

SUBJECT: Movements in Tea Prices

1. World tea production has consistently exceeded world consumption for the last fifteen years. Specifically in 1960-65, world output expanded at 2.9 percent per annum, whereas world import demand grew at only 1.3 percent per annum. Although consumption in the developing producing countries (which account for 34 percent of world consumption) grew at 5 percent per annum, it failed to absorb the difference between output and exports, with the result that stocks have continued to rise. The consistent pressure on prices affected the higher priced North Indian and Ceylonese teas much more than the comparatively cheaper quality teas from Africa.

2. The 1969 tea harvest is expected to be about 3.3 percent larger than in 1968; this compares with a 3 percent increase in the previous year. On the other hand, the increase in world consumption remained under 3 percent. World stocks have risen to their highest level in 30 years. In spite of the general concern about the movement of tea prices, recent international consultations on price stabilization and production controls have ended in an impasse.1/ As a result of the cumulative pressure of oversupply and the psychological impact of unsuccessful stabilization efforts, tea prices declined rather sharply by 8 percent in the first 9 months of 1969, as compared to the corresponding period in 1968. It is unlikely that these trends will be reversed for some time with the result that tea prices may weaken further.

1/ However, a consultative Study Group on Tea has been established under the aegis of the Food and Agriculture Organization of the United Nations.

Attachments

cc: Mr. Stevenson
Chief Economists

President has seen

OCT 24 1969 - Returned
4 p.m.

OFFICE MEMORANDUM

TO: Mr. Andrew M. Kamarck DATE: October 17, 1969

FROM: Shamsher Singh

SUBJECT: Coffee Price Prospects for 1969/70

1. In the past three seasons (October-September 1966/67 to 1968/69) world production, mainly due to weather conditions, has remained below world consumption of coffee. The shortfall was met by drawing on the large stocks held by major exporting countries, mainly Brazil (Chart 1). In spite of these persistent shortfalls, prices have been weak throughout these years; they were particularly depressed during January-July of 1969, when in "real" terms they had come close to the low level of 1962, which the Agreement is committed to defend as the floor.

2. At the August session of the International Coffee Council, producing countries expressed dissatisfaction and requested upward adjustment of ICO indicator prices so as to compensate, at least in part, for the reduced purchasing power of the dollar. Importing countries opposed the principle of such escalation, but were willing to concede a modest price adjustment. Consequently, by general consensus, both the floor and ceiling prices for the four groups of coffee were uniformly raised for the 1969/70 season by 1.5 cents per pound as compared to those for 1967/68 and 1968/69.

3. The ICO action has been overshadowed, however, by recent speculative price increases, subsequent to the news of frost and drought damage to the 1969/70 Brazilian crop. Prices have, at least temporarily, risen well beyond the new ceilings.

4. It is estimated by the United States Department of Agriculture that the new Brazilian crop would amount to 20 million bags implying that stocks would have to be drawn down by another 6 to 7 million bags to meet the probable level of domestic and export demand in 1969/70. World production in 1969/70 estimated at 65 million bags would fall short of world demand by about 6 million bags.1/ However, world stocks of 45 million bags at the beginning of the current season (Chart 1) are ample in supplementing current production. Nonetheless, speculative buying has raised prices considerably above the ceilings set by the ICO as indicated below:

	1969/70		Latest Quotation
	Floor	Ceiling	(Oct. 9, 1969)
	(U.S. cents per pound ex dock New York)		
Colombian Milds	40.75	44.75	50.50
"Other" Milds	38.75	42.75	45.79
Unwashed Arabicas	36.75	40.75	45.50
Robustas	32.00	36.00	37.25

1/ Barring further weather hazards, average world capacity (as distinct from the current crop) should remain above the level of world demand for some years to come. Demand is expected to grow at about 2.5 percent per annum.

5. Should prices stay above the ceilings for 15 to 20 consecutive market days, export quotas for 1969/70, initially set at 46 million bags, would have to be raised automatically under the terms of the Agreement. The ICO Secretariat has estimated that in that case quotas for the first (October-December) quarter might be raised by as much as 3 million bags. In the unlikely event of a persistent tendency of prices to exceed the ceiling in the January-March quarter, an increase by another 2 million bags is expected, which would bring the aggregate 1969/70 quota to 51 million bags, substantially beyond the current ICO estimate of demand on quota markets of 46 million bags. If exporters increase their offers in line with quota increases, prices should return to levels within the newly established ranges (Chart 2). The tentative forecasts of average prices for the 1969/70 season shown below (compared to those in earlier years) are based on the assumption that countries will not deliberately withhold supplies.

	Actual				Forecast
	1965/66	1966/67	1967/68	1968/69	1969/70
	----- (U.S. cents per pound ex dock New York) -----				
Colombian Mams	48.6	42.5	42.5	42.0	44.5
Guatemala Prime Washed	43.8	39.4	39.6	38.0	42.0
Santos 4	41.8	38.6	37.2	38.1	40.5
Angola Ambriz AA	35.0	33.4	34.5	32.4	35.0

6. If Brazil, however, failed to fulfill its quota, and thereby became instrumental in maintaining a higher price, a greater financial gain, in relative terms, of such a development is likely to accrue to countries which are in a position to export larger volume of coffee. These include the Ivory Coast, Angola, Uganda and El Salvador who expect to harvest their second highest crop in 1969/70.

7. A critical question is the extent of permanent damage that the frost may have caused to the Brazilian trees. A fresh review of world capacity, supply demand relationships and price prospects beyond 1969/70 will be issued after the return of the Agriculture Sector Mission to Brazil, in which the Economics Department is participating.

Attachments

cc: Mr. Stevenson
Chief Economists

FORM No. 58 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara **DATE:** October 23, 1969

FROM: Irving S. Friedman

SUBJECT: Papers on Argentina, Korea, and Domestic Procurement

In view of your interest in this subject you may find it interesting to skim through these papers, if time permits.

ISF

OCT 27 1969 President has seen

(Returned - 2 p.m.)

FORM No. 57

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

OFFICE MEMORANDUM

TO: Mr. Irving S. Friedman

DATE: October 17, 1969

FROM: Bela Balassa

OCT 17 1969

5:30 pm

SUBJECT: Papers on Argentina, Korea, and Domestic Procurement

1. The enclosed papers on trade policies in Argentina and Korea were prepared following a short stay in the two countries at the invitation of their governments. The papers can be taken as a demonstration of your thesis that there are no "universal" strategies which would be applicable to all countries. In both instances, I tried to fit my recommendations to the situation existing in the country, although the underlying principles remain those I have expressed in "Industrial Protection and Project Selection in Developing Countries," prepared earlier for Mr. McNamara. This is the paper we talked about briefly today; a copy is enclosed in case yours is missing.

2. I also enclose a copy of my comments on the papers prepared for the Advisory Committee on Domestic Procurement.

Enclosure

TRADE POLICY IN ARGENTINA

The March 1967 Reform

1. The basic features of the system of protection in Argentina prior to the March 1967 reform can be summarized as follows: (a) a high degree of protection of manufactured goods entailing a discrimination against agricultural products, (b) discrimination in favor of producing for domestic use and against the export of manufactured goods; (c) a considerable degree of haphazardness in the tariff structure; and (d) a recurrent inflation-devaluation cycle.

2. The March 1967 reform was designed to introduce improvements in the system of protection and to cure the balance-of-payments deficit existing at the time. A devaluation from 255 to 350 pesos to the dollar was accompanied by a reduction in tariffs on nonagricultural products from an average of 119 to 61 percent. In turn, the 18 percent rebate on the exports of manufactured goods was discontinued at the time of the reform but was later reinstated in a different form and at slightly lower rates. Also, a 25 percent tax was levied on agricultural exports but this has since been reduced to a considerable extent. These measures were accompanied by a policy of wage control and an informal control of prices.

3. Tariff reductions were carried out on the basis of tariff norms established according to a three-fold system of classification, depending on the use of the commodity, the extent of import competition, and the degree of fabrication. With few exceptions, above-norm tariffs were reduced to the level of the norm while below-norm tariffs remained unchanged. The tariff norms are highest for consumer goods, followed by capital goods and material inputs; they also rise from lower to higher levels of fabrication; finally, higher norms were set on domestically produced commodities that have close foreign substitutes as compared

to goods with imperfect substitutes, and are lowest on commodities that are not produced domestically. The enclosed table shows the tariff norms presently in effect.

Effects on Industrial Protection

4. It was assumed that the average nominal protection of manufactured goods -- tariffs adjusted for the devaluation of the peso -- would not be affected by the reform. Thus, the domestic price of a product with a world market price of one dollar and receiving average protection, was calculated at 559 pesos (2.19 x 255) before devaluation and 567 pesos (1.61 x 350) afterwards. But these averages do not adequately represent changes in the levels of protection following the reform, and it is more appropriate to consider the various product groups individually.

5. To begin with, in the case of commodities that are not produced domestically, an unweighted average of tariffs, adjusted for devaluation, has remained the same, yet an average of these tariffs weighted by imports as well as the index of import prices shows an increase of over 20 percent immediately following the devaluation. These results are explained by the large weight of items for which nominal protection has risen as a result of the devaluation. Accordingly, increased incentives were provided for replacing imports by domestic commodities. The rise in import prices had similar effects on products that do not have close substitutes among imports.

6. As regards domestically produced commodities with close foreign substitutes, the data show no change in average nominal protection. Different conclusions are reached, however, if we consider that the reduction of above-norm tariffs often mean a decrease in "potential" protection rather than in the protection actually utilized. A study by CONADE shows that in 1965 Argentine industries

utilized on the average one-half of the protection provided by tariffs; this proportion was smaller for consumer goods which had the highest tariffs and greater for intermediate products and machinery that were subject to relatively low duties. In turn, with below-norm tariffs left unchanged, the nominal protection of such commodities increased by the extent of devaluation, i.e. by 37 percent.

7. A further consideration is that the reform increased the escalation of the tariff structure, with tariffs rising with the degree of fabrication. Escalation is especially pronounced in the case of intermediate products with close imported substitutes where tariffs vary from 50 to 130 percent. Differences are large also between intermediate products and capital goods, on the one hand, and consumer goods, on the other, with tariffs averaging 50 percent and 87 percent, respectively, in the case of the former and 136 percent for the latter. Finally, an unweighted average of tariffs on commodities that are not produced domestically (mostly intermediate products and machinery) is only 25 percent, as compared to 48 percent on goods without close substitutes, and 87 percent on those with close substitutes.

8. These considerations should not obscure, however, the important achievements of the reform. While on previous occasions a devaluation increased protection by its full extent, in March 1967 it was accompanied by a reduction in tariffs that pulled in the opposite direction. Moreover, although the protection of manufactured goods appears to have increased immediately after the reform, the 22 percent increase in domestic prices between the first quarters of 1967 and 1969, as well as the discontinuation of the earlier practice of permitting industrial representatives to "mark up" the prices of imports for purposes of tariff setting, have subsequently reduced the extent of protection. Finally, with increases in wholesale prices not exceeding 4 percent between the

first quarters of 1968 and 1969, a reasonable degree of price stability has been reached, and the stability of prices together with the measures introduced during this period have provided a boost to exports.

Effects on Exports

9. While in the year following the reform, the effects of the 37 percent devaluation on the exports of manufactured goods were roughly offset by the elimination of the 18 percent export subsidy and by an 18 percent increase in domestic prices, new measures introduced in 1968 have provided inducements to these exports. A 12 percent subsidy, said to represent a refund of indirect taxes, is now in effect; exporters receive beneficial treatment on income taxes; and they get a drawback for duties paid on imported inputs. These measures, totalling on the average about 16-18 percent of the export price, have contributed to the roughly 50 percent increase in the exports of manufactured goods between 1967 and 1968. Exports have also been helped by tariff reductions in LAFTA that takes over one-half of Argentine exports of manufactured goods and by the nearly 100 percent subsidy to steel exports to the United States.

10. The consequences of the reform for traditional exports, too, have been favorable. Although the 25 percent export tax imposed at the time of the reform and the rise in the prices of agricultural inputs nearly offset the effects of the devaluation immediately after the reform, export taxes have subsequently been reduced to 6 percent in the case of wheat, 8 percent on most other cereals, 10-15 percent on unprocessed meat, while no export tax applies on processed meat. These measures have helped to overcome unfavorable developments in some foreign markets and have led to a slight improvement in the terms of trade between agriculture and manufacturing industry.

11. Notwithstanding the changes, the basic character of the system of protection has remained more-or-less the same. It continues to protect especially manufacturing industries whose products have close foreign substitutes and, to a lesser extent, products that have imperfect substitutes. The unweighted average of tariffs in the first group of products is 87 percent, in the second group 48 percent, and on imports that have no domestic substitutes 25 percent. Net nominal protection (i.e. protection adjusted for overvaluation as compared to a free trade situation) is lower, however, since in the absence of tariffs the equilibrium exchange rate would be higher than it is under protection. The low exchange then implicitly subsidizes imports and partially offsets the protective effects of the tariff. If, for example, the exchange rate were one-third higher under free trade conditions, the net protection of domestic products that have close foreign substitutes would appear to be 40 percent, that of products with no close import substitutes approximately 10 percent, while imports that do not compete with domestic production seem to receive a small subsidy and agricultural products are subject to implicit tax of about 33 percent. This implicit tax is additional to the export taxes actually levied in agriculture.

12. A tax of this magnitude on agriculture might be justified on the assumption that demand for Argentine traditional exports is rising at a slow rate and is not responsive to price changes. These assumptions are called into question, however, if we consider that world demand for the major Argentine export products has been expanding at a rapid rate. The rate of growth of the world exports of these commodities was 6.5 percent between 1950-53 and 1963-66 and as much as 7.9 percent in the first half of the sixties. With rapidly rising demands for meat, the rate of expansion might not slacken much and Argentina could increase her agricultural exports at such rates without encountering a decline in prices.

Effective Protection in Argentina

13. In regard to manufactured goods, two further considerations should be introduced. For one thing, in some industries, mostly in those producing non-durable consumer goods, the margin provided by protection is not fully utilized because internal competition has reduced the domestic price below the sum of the import price and the tariff. For another, the escalation of the tariff structure raises the effective rates of protection on commodities of higher levels of fabrication, and especially on consumer goods, much above the nominal rates. Thus, some consumer goods are subject to tariffs of 120-140 percent while their material inputs and machinery are dutiable at 70-90 percent if they are available domestically and 20-50 percent if they are not. If, say, inputs in the former category account for 40 percent and those in the second category for 20 percent of the import price, the effective rate of protection appears to be more than double the nominal protection. This conclusion is not affected if we assume that tariffs levied on domestically produced goods are not fully utilized, although the absolute magnitude of protection will now be smaller.

14. Effective protection on intermediate products is less than on consumer goods, in part because tariffs on these products are lower, and in part because the differences between tariffs on outputs and inputs are smaller. Nevertheless, tariffs on intermediate products rise with the degree of fabrication, thereby leading to even larger increases in effective rates. Finally, effective protection on capital goods is generally lower than on consumer goods and the variations within the group are due mainly to intercommodity differences in the share of imported inputs. Products that use many domestically produced intermediate inputs (e.g. steel) have relatively low effective protection while those where imported machine tools account for a large part of the cost have high protection.

15. The high level of protection of the Argentine manufacturing sector can hardly be rationalized on infant industry grounds. Rather, it appears that protection is excessive in the sense that it permits small, marginal firms to operate profitably and the "cushion" provided by protection reduces the incentives for competition and technological change. These considerations apply with especial force to nondurable consumer goods which are mature industries in Argentina and yet receive higher than average protection. Also, there seems to be no economic reason for the observed escalation of effective rates with the degree of fabrication.

16. High protection of domestic production, along with the disincentives to export, has led to inadequate specialization in the manufacturing sector. The principle of comparative advantage finds little application within this sector; firms tend to produce a large variety of commodities; and the policy of protection discourages the international exchange of parts, components, and accessories. These considerations in part explain that while the share of the resources devoted to the manufacturing sector is about as high in Argentina as in Italy, and the industrial composition of this sector is similar in the two cases, manufacturing productivity in Argentina is only about half that in Italy.

Recommendations for the Future

17. It is easy to suggest what a country should have done twenty years ago; what it should aim at in the distant future after all its industries have become competitive; or what it should do at present if there were no political or other constraints limiting its scope of action. Instead of dealing with an "ideal" situation, the following recommendations cover a relatively short period, with account taken of the constraints on economic policy. It is assumed that further changes in the system of protection will be necessary at the end of the period but these are not considered in the memorandum.

18. In making recommendations, I have perused several position papers prepared within and outside the Argentine government and have drawn on the results of conversations with government officials, businessmen and economists in Argentina. The recommendations should be regarded as a "package" whose individual parts are interdependent as far as their effects on the Argentine economy are concerned. It would also be desirable to make the application of the proposed measures automatic in the sense that the government announces its policy and the measures to be taken, several years ahead.

19. The proposed scheme extends over a period of five years, with annual steps. While the length of the period has been chosen somewhat arbitrarily, practical considerations suggest that it should not be less than three nor more than six years. In this way, a reasonable degree of certainty can be provided for business firms while the government does not limit its scope of action for an overly long period during which the underlying conditions may change. Finally, the proposed scheme includes provisos for a possible slowing down or acceleration in the steps to be taken.

20. A key assumption underlying the recommendations is that Argentina will continue to maintain a reasonable degree of price stability. This assumption would be called into question if the negotiations scheduled for the Fall result in wage increases exceeding 7-8 percent. In that eventuality, it might not be possible to maintain the present exchange rate and/or a disguised devaluation in the form of tariffs and export subsidies would become necessary. Such a situation would necessitate modifications in the scheme, and would make its application more difficult by creating uncertainty concerning price changes. On the other hand, it would remove one of the constraints by allowing for variations in the exchange rate.

21. If price stability is not disturbed by cost-push inflation, the proposed

scheme also envisages the maintenance of the present exchange rate. In theory, the absence of this constraint would permit greater flexibility in policy making by increasing the number of alternative policy combinations. In practice, however, a devaluation would not only lead to increases in costs and prices but would engender expectations for the continuation of the inflation-devaluation spiral.

22. In making policy recommendations, one should further take account of the need to avoid creating politically undesirable changes in income distribution, inflationary pressures, unemployment, a decline in profits, a deterioration of the balance of payments, and an overly large burden on the federal budget. This is a formidable set of constraints and some of the policies that have been suggested by various groups violate several of them. For example, reductions in tariffs by themselves would adversely affect employment, profits, and the balance of payments. By contrast, in the present full employment situation, large subsidies to exports of manufactured goods would create pressures for wage and price increases, and provide a windfall profit for at least some producers.

Long-term Objectives

23. A review of Argentina's postwar experience prior to the March 1967 reform indicates continuing inflation-devaluation cycles and recurrent balance-of-payments deficits. Excessive claims on the part of various social groups contributed to the inflation while earnings from exports fell short of the import requirements of full employment income, thereby creating the need for devaluation in periods of expansion. Devaluation, in turn, was customarily accompanied by a recession because it could not succeed without the application of restrictive monetary policies.

24. The March 1967 reform stopped the inflationary spiral by wage controls and informal agreements with the major firms to freeze prices. It also led to an improvement in the balance of payments, largely through the effects on imports of the stagnation of national income in the first year after the reform. But imports rose rapidly as incomes increased again, rising by 40 percent between the first five months of 1968 and 1969. This result shows the high income elasticity of import demand in Argentina, due to the high imported machinery content of new investment and the direct and indirect import needs of the rise in the consumption of manufactured goods -- both of which tend to increase faster than incomes.

25. Continuing growth in the Argentine economy thus presupposes a rise in export earnings at a rate exceeding the growth of national income. It also necessitates improvements in the structure of manufacturing industries to ensure rapid increases in productivity while providing full employment. Furthermore, the policies followed should be conducive to the maintenance of price stability.

Incentives to Agriculture

26. Agriculture and food processing continue to provide nearly nine-tenths of Argentine exports. Thus, a given increase in total exports could be brought about by a much smaller percentage change in these exports than in foreign sales of manufactured goods. More importantly, the cost in terms of domestic resources of expanding agricultural exports is less than that of increasing manufactured exports. These considerations indicate the need for reducing discrimination against agriculture which may entail reducing or eliminating export taxes. But reductions in these taxes would have to be undertaken gradually, in part because of short-term market limitations for the expansion of some of these

exports and the low short-term elasticity of supply, and in part because the ensuing rise in prices would create inflationary pressures while leading to the redistribution of incomes from wage-earners to farmers and reducing budgetary revenue.

27. At the same time, it is imperative to lessen uncertainty for the farmer so that he can undertake expansion schemes looking several years ahead. This purpose would be served by setting the objectives of government policy for agriculture that should be reached at the end of the five-year period. The objectives would have to be determined for each major export product individually, since their market possibilities may differ to a considerable extent. Thus, export taxes might be maintained on wheat whose prospects appear rather dim but eliminated on corn that has good export possibilities. In the case of meat, reductions in export taxes on chilled meat might be accompanied by export subsidies to producers of processed meat to maintain the present margin between the two. Consideration should further be given to assisting the exports of other processed foods.

28. To avoid the income-distributional effects of the reduction in export taxes and to encourage the better utilization of land, the budgetary cost of the lowering of export taxes could be recouped by increasing the land tax. Receipts from a higher land tax could also be used to encourage increases in agricultural productivity through extension services, agricultural research, and disease control. The example of the United States and some Asian countries indicates that the yield on such investments is high, yet Argentina lags behind in this respect.

Incentives to Manufacturing

29. Notwithstanding the advantages offered by agriculture, it would not be

appropriate to rely exclusively on agricultural exports to accelerate economic growth. The reason for this recommendation is not so much a pessimistic appraisal of the medium-term export prospects for agriculture as the anticipation of potential benefits the expansion of exports could bring to the manufacturing sector. This sector utilizes 32 percent of domestic resources in Argentina, and its continuing growth appears necessary to maintain full employment and to avoid a decline in profits that would have detrimental effects on investment activity.

30. The growth of manufacturing is understood to mean not simply an extension of production at present levels of productivity but rather increases in productivity. This, in turn, presupposes structural changes in the manufacturing sector that would be furthered by encouraging increased specialization among as well as within industries, discouraging high cost operations, and providing incentives for the expansion of relatively efficient firms and industries as well as for technological progress.

31. The desired transformation of Argentine manufacturing industries could be given impetus through a scheme of gradual reductions in import tariffs accompanied by gradual increases in export subsidies. Under such a scheme, the manufacturing sector as a whole could continue to expand but this expansion would be accompanied by shifts in production from industries with lower productivity to those with higher productivity, and efficient firms would gain at the expense of inefficient ones within individual industries. Apart from encouraging interindustry and intraindustry specialization, incentives to export would also permit the use of large-scale production methods in exporting firms while exposure to competition in the world market would encourage improvements in technology and in product quality.

Subsidies for Manufactured Exports

32. It has been suggested by some that the rate of export subsidies should be set to be equal to the rate of tariffs, which would amount to applying preferential exchange rates to manufactured goods. This recommendation has merit as a long-term proposition provided that tariffs are brought down to reasonable levels, since it would equalize incentives to production for domestic markets and for exports. But its application is objectionable in the present state of Argentine industry, in part because levels of protection after tariff reductions considered to be feasible over a five-year period would still permit the operation of relatively inefficient firms, and in part because it would provide large profits for a few firms.

33. It would appear more appropriate to gradually increase export subsidies so that they reach, say, one-third to one-half of the rate of duty applied at the end of the five-year period. The subsidies would be a smaller proportion of relatively high tariffs and a larger proportion of a low tariff. Thus, one could envisage an export subsidy of 25 percent on commodities that are protected by an 80 percent tariff, a 20 percent subsidy in cases where the tariff is 50 percent, and a 15 percent subsidy in the case of a 30 percent tariff. Absolute differences in the proposed rates are explained by the need for some degree of escalation in tariffs at higher stages of processing, as noted below.

34. These subsidies would be additional to refunds of indirect taxes which are now set at 12 percent of the product price. On the other hand, it does not seem appropriate to maintain income tax refunds and drawbacks of tariffs paid on imported materials and equipment, especially since the latter encourages the importation of such products. Accordingly, a 20 percent export subsidy together with a refund of indirect taxes would be about 15 percentage points higher than the actual rate of the subsidy.

35. Recommendations for the imposition of export subsidies raise questions concerning possible conflicts with LAFTA and GATT rules. The former does not seem to create much of a problem since Chile and Uruguay also supply such subsidies while Brazilian exports benefit from the relatively high exchange rate associated with large export taxes on coffee. Furthermore, several other developing countries, such as India, Pakistan, Korea, and Taiwan, rely on subsidies to promote their exports of manufactured goods. The acceptance of this practice reflects a desire on the part of GATT and some developed nations to see a change in the pattern of the exports of developing countries. Nevertheless, possible reactions on the part of major importing countries would need to be explored.

Import Tariffs

36. Import tariffs should also be reduced on a sliding scale, the percentage decrease being larger for the higher tariffs. The resulting fall in the dispersion of duties appears desirable since high tariffs are more likely to provide excess protection and, to the extent that they are fully utilized by at least some firms of the industry, entail a high cost for the national economy.

37. As an illustration, one might envisage that duties of 140 percent are reduced to 80 percent, those of 100 percent to 60 percent, and those of 60 percent to 40 percent. For the individual firm, however, changes in the tariff-inclusive price of imports is relevant. This price would decline by 25 percent in the first case, 20 percent in the second, and 12.5 percent in the third. Such decreases are not uncommon; in France and Italy the establishment of the Common Market led to the elimination of tariffs of 20-30 percent on the imports of a wide variety of manufactured goods from the member countries within a period of eight years.

38. The proposed method of tariff reductions would reduce the degree of escalation of nominal rates, as well as the differences in duties between consumer goods, intermediate products, and capital goods, and the tariff disparities between domestically produced goods with close foreign substitutes, imperfect substitutes, and no substitutes. The decrease in the dispersion of the effective rates of protection would be even larger, and this purpose would also be served by foregoing duty reductions, or keeping such reductions small, in the case of goods that are not produced domestically. The escalation of effective protection would be further reduced by limiting the number of processing levels to four instead of the present ten. The enclosed table shows illustrative magnitudes of tariff changes.

39. This is not to say that some degree of escalation of tariffs should not be retained. Indeed, there is justification for slight increases in tariffs with the degree of fabrication for the sake of keeping effective rates of protection in individual industries approximately the same. This conclusion follows if we assume that all raw materials are available at world market prices, as seems to be the case in Argentina with a few exceptions such as cotton. Let us take the case where the material inputs account for 60 percent of the world market price of every stage of processing. A 20 percent tariff on the product in the first stage would thus provide 50 percent effective protection and the same effective protection could be ensured at the second, third, and fourth stages by imposing tariffs of 32 percent, 40 percent, and 44 percent respectively.

40. Furthermore, it seems appropriate to have higher tariffs on consumer goods in part because there is often an irrational preference for foreign merchandise, and in part because the state may wish to impose a tax on the demand for the variety in consumption imports provide. These considerations do not play a role in the intermediate products category which includes mostly standardized goods,

but the irrational preference arguments might have some applicability to capital goods.

Effects on Industrial Production and the Budget

41. While tariff reductions encourage the substitution of imports for domestic production, export subsidies contribute to the expansion of industrial output. However, the net effects of the simultaneous application of the two cannot be foreseen with confidence. Provisions would have to be made therefore to avoid, on the one hand, a slackening in employment and decline in profits associated with a deceleration of the growth of industrial production due to increases in imports, and, on the other, the creation of inflationary pressures accompanying a rapid expansion of exports. A possible way is to provide in the scheme for temporarily halting reductions in tariffs whenever industrial production is rising less than a predetermined percentage, say 3 percent a year, and to postpone the next step in raising subsidies whenever the annual increase in industrial production exceeds, say, 7 percent.

42. While these provisions would ensure steady increases in industrial production, the problem remains that both tariff reductions and export subsidies have a direct budgetary cost. Reductions in tariffs lead to increased imports, but the price elasticity of import demand would have to be rather high in order to recoup the lost revenue. Nevertheless, about one-half of the lost revenue will be recouped if we assume a decline in tariffs from 100 to 60 percent and calculate with a price elasticity of import demand of 2. The elasticity may be lower at the early stages of tariff reductions when there is still some redundancy in protection, and higher afterwards.

43. In turn, while in a study prepared for CONADE it was estimated that each dollar of export subsidies would increase government revenue by $1.20 through

its multiplier effects on domestic incomes, this calculation has been based on the assumption of underemployment which is not the case in Argentina. Still, even in a full employment situation, export subsidies would contribute to some increase in national income through the improvements in the utilization of resources, and at least part of lost revenue would be regained through higher tax receipts.

44. The impact of the proposed scheme on the government budget would need to be estimated under varying assumptions. If, for example, import tariffs are reduced by 10 percentage points in the first year, and the import demand elasticity is 2, the loss in revenue would not exceed 5 billion pesos. A 10 percent export subsidy on exports of manufactured goods excepting steel would also cost 5 billion pesos if these exports increased initially by one-half. The total cost for the budget would thus be 10 billion pesos in the first year of the operation of the scheme, amounting to two percent of the budget of the national government. This is a comparatively small figure if we consider past variations in tariff revenue and would not represent much of a burden on the budget.

45. Moreover, the budgetary cost of the scheme would not increase in proportion to the net amount of export subsidies and reductions in tariff receipts in subsequent years since the expansion of exports would permit reaching a growth rate of national income that would not be attainable otherwise. This effect of export subsidies on the growth rate would ultimately provide tax revenue to compensate for the budgetary cost of tariff reductions and export subsidies.

46. Turning to the implications of the scheme for price stability, it should be noted that the present wage and price controls can hardly be continued indefinitely. At the same time, high protection -- and the expectation that tariffs would be raised in the event of price increases -- make it possible for

firms to meet wage demands and to pass on wage increases in the form of higher prices. A lowering in tariff protection, then, may also serve as an anti-inflationary measure and it has indeed been used as such by several European countries. Under Argentine conditions, too, it can be expected that tariff reductions would tend to lessen inflationary pressures and to bring supply and demand in particular markets into balance.

Conclusion

47. The purpose of the proposed scheme is to improve the growth prospects of the Argentine economy by increasing the rate of growth of exports, improving the structure of manufacturing industries, and contributing to the price stability. The scheme includes lessening discrimination against agricultural products, as well as gradual reductions in tariffs accompanied by increases in subsidies for the exports of manufactured goods. It would also reduce the escalation of tariffs and lessen differences in duties among various groups of commodities. It is suggested that the scheme be carried out over a predetermined period with annual changes determined in advance but subject to certain escape clauses.

ACTUAL AND SUGGESTED TARIFF LEVELS IN ARGENTINE MANUFACTURING

(percent)

		LEVELS OF PROCESSING									
		1	2	3	4	5	6	7	8	9	10
Consumer Goods											
With close foreign substitutes	A	110	110	110	120	120	130	130	130	140	140
	S			60	70	70	75	75	80	80	80
Without close foreign substitutes	A	70	70	80	90	90	100	110	110	120	
	S			50	50	50	60	60	70	70	
Not produced domestically	A	30	40	50	60	70	80	90	100	110	130
	S			30	45	45	50	50	60	60	
Intermediate Products											
With close foreign substitutes	A	40	50	60	70	80	90	100	110	120	130
	S		40	40	50	50	60	60	70	70	
Without close foreign substitutes	A	20	20	30	30	40	50	60	60	70	80
	S		15	15	20	20	40	40	50	50	
Not produced domestically	A	5	5	10	10	20	20	30	30	40	40
	S		5	5	10	10	20	20	30	30	
Capital Goods											
With close foreign substitutes	A	40	50	60	70	70	80	80	90	90	100
	S					45	50	50	60	60	60
Not produced domestically	A	30	30	30	40	40	40	40	50	50	50
	S					30	35	35	40	40	40

Note: "A" refers to actual tariffs

"S" refers to suggested tariffs to be reached at the end of the Five Year Plan.

In cases where suggested tariffs are not given, no commodities come under the category.

TRADE POLICY AND PLANNING IN KOREA

By Bela Balassa *

Growth Performance

1. Korea is one of the success stories. With an average annual growth rate of 8.4% during the 1960's, it ranks high among developing countries. Korea's performance was especially favorable after the 1966 reform of the exchange rate and the system of protection. While its Gross National Product increased at a rate of 6.2% a year between 1960 and 1964, the growth rate was 10.7% between 1964 and 1968. The corresponding figures in per capita terms are 3.3% and 8.2%.

2. The main stimulus to growth was provided by exports that rose at an annual rate of 20% in the first half of the period and 40% in the second. Correspondingly, the share of exports in GNP, expressed in 1965 prices, increased from 4.0% in 1960 to 6.5% in 1964 and to 17.8% in 1968. The effects of export expansion on national income are shown even more dramatically if we consider marginal export-income ratios; these were 15.4% in the first four years and 38.4% in the second. Throughout the period, manufacturing was the leading sector, with its share in GNP rising from 13.7% in 1960 to 15.6% in 1964 and again to 23.5% in 1968.

3. The rapid growth of exports reflects the willingness and the ability of Korean producers to respond to export incentives. Exports received considerable stimulus from the adoption of a realistic exchange rate in 1964 and were helped by a variety of measures afterwards. In turn, the investment necessary for the growth of national income was provided by increases in foreign as well as in domestic savings. In terms of current prices, between 1960 and 1968 the former rose from 8.5% to 11.6%, and the latter from 2.4% to 15.1% of the Gross National Product. Increases were the largest in public savings, from -2.8% of GNP in 1960 to 6.4% in 1968. This increase was assured by a stepped-up tax effort while the share of public consumption in GNP hardly changed.

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* The recommendations contained in this paper express the opinions of the author; they do not necessarily represent the views of the World Bank.

Danger Signals

4. Some recent changes, however, temper an optimistic appraisal of Korean economic performance. To begin with, imports have risen even more rapidly than exports in the last few years and have increased by nearly one-half between 1967 and 1968 (the results remain practically the same if we exclude grains). Thus, while the ratio of merchandise exports to imports improved immediately following the exchange rate reform, it has since continuously declined. Having risen from 29.5% in 1964 to 37.8% in 1965, this ratio fell to 34.9% in 1966, to 37.7% in 1967, and again to 33.6% in 1968. In the latter year, the absolute increment in imports ($472 million) approximately equalled the total amount of exports ($486 million).

5. The situation appears even less favorable if we consider that some of the exports are connected with the Vietnam war, which may not continue for long. The war has also helped the Korean balance of payments by increasing service earnings which covered part of the deficit in the trade balance. This has not been sufficient, however, to avoid a deterioration in the current account of the balance of payments. The deficit has been financed by the inflow of foreign capital, which has again become an increasingly important source of domestic investment. In 1968, foreign saving financed 44% of domestic capital formation, as against 39% in 1966 and 41% in 1967. The ratio is even higher, 52%, in 1968 if the figures are expressed in 1965 prices.

6. This change has been accompanied by a shift in the composition of the inflow of foreign capital. Foreign grants have declined in absolute terms, and the rise in public loans has been overshadowed by the increase in private credits, which reached two-thirds of the total inflow in 1968. The shorter repayment period and higher interest rates on private loans have, in turn, contributed to the increase in Korea's debt burden. According to Government sources, debt service payments (excluding short-term credit) rose from negligible levels to 6% of exports in 1968 and are expected to reach 14% in 1970.

7. On the domestic side, the rapid wage increases and the concomitant decline in profit shares gives cause for concern. The rise of monthly earnings in manufacturing accelerated after 1966; in 1968, average increases were 27.2% in nominal terms and 14.5% in real terms. Wage increases have far exceeded the growth of productivity, while foreign competition has restrained increases in prices (wholesale prices rose 25% between 1965 and 1968) so that the share of labor costs in value added in manufacturing has risen to a considerable extent.

Between 1965 and 1968, wages increased 83% and employment 48%, resulting in a 170% rise in labor costs as compared to a 120% increase of value added, in current prices.

8. The rise in labor costs exceeding increases in prices has entailed a decline in profit margins. In manufacturing industries, the ratio of profits to sales declined from 7.7% in 1966 to 6.7% in 1967, and again to 5.9% in 1968. The decrease has been the most pronounced in textiles, clothing and footwear, paper and paper products, leather and leather products, clay, glass and stone products, and basic metals, while more favorable results are shown for machinery and transport equipment.

9. The decline in average profit margins shown for individual industries, and for manufacturing in general, covers considerable variation among firms. Firms with large indebtedness have been especially adversely affected, and there are reports of bankruptcies in several industries.

Causes of Recent Developments

10. A major cause of the widening trade gap and the rapid wage increases has been the overheating of the economy. While in the period immediately following the 1964 reform, the course of expansion was smoothed by the availability of unemployed and under-employed labor, in subsequent years it has increasingly impinged on the labor supply. Although employment continued to rise at a rapid rate, the transfer of labor from agriculture to manufacturing and the training of skilled workers has not been fast enough to avoid inflationary wage increases.

11. The acceleration of the growth of manufacturing production has reinforced these tendencies. Value added in manufacturing expressed in constant prices grew 16% in 1966, 23.9% in 1967, and 28.1% in 1968. Wage increases followed a similar path, with average monthly earnings rising 17.4% in 1966, 22.2% in 1967 and 27.2% in 1968.

12. The acceleration of manufacturing growth has also required higher investments, with gross domestic capital formation rising from 14.7% of GNP in 1965 to 26.7% in 1968. In turn, given the limitations of domestic capacity in some areas, the increase in manufacturing production has necessitated higher imports of raw materials and intermediate products while the expansion of investment activity has entailed

larger imports of machinery and equipment.

13. The dramatic increase of foreign commercial loans in 1967 and 1968 has also contributed to the expansion of investment goods imports, and hence to investment activity. Last but not least, imports have been stimulated by the deterioration in the competitive position of domestic producers. As a result of these influences, the imports of raw materials and intermediate products more than doubled between 1965 and 1968, while the imports of investment goods increased sevenfold, leading to a tripling of merchandise imports. In the same period, the Gross National Product increased 40% (Table 1).

Exchange Rate Policy and Competitiveness

14. At the time of the 1964 reform, it was assumed that the exchange rate would depreciate pari passu with increases in domestic prices. This has not happened, and the rate has changed only from 265 won in 1965 to 277 won in 1968. To alleviate the adverse effects on the trade balance of the virtual constancy of the exchange rate in the face of rapidly rising domestic prices and wages, the Government has applied a variety of measures on a piecemeal basis.

15. In the course of the 1964 reform, multiple exchange rate devices such as cash subsidies to exports and export-import linking arrangements were eliminated. Subsequently, however, various incentives to exports have been introduced to offset increases in domestic costs and prices. These incentives include exemptions from customs duties on imported materials and capital equipment used in the production of exports; exemption from the business activities and commodity tax as well as rebate of such taxes already paid; reduction by 50% of income taxes on profits earned from exports; export credit and loans for the purchase of raw materials and equipment at preferential rates; an export-import linkage system that permits exporters to import goods on the prohibited list for own use or for resale; high wastage allowances on imported raw materials; and preferential electricity and transportation rates.

16. The incentives to export have been increased continuously in order to avoid a deterioration in the competitive position of exporters. As Table 2 indicates, tax and customs exemptions rose from 31.6 won per dollar value of exports in 1965 to 66.7 won in 1968, while the value of interest rate concessions increased from 6.5 to 15.1 won. Adding

TABLE 1

IMPORTS BY COMMODITY GROUPS

(In million dollars)

	1963	1964	1965	1966	1967	1968
Grain	107.2	60.8	54.4	61.3	76.6	129.4
Capital Goods	115.6	69.5	73.1	171.7	310.2	533.2
Raw Materials	314.6	260.0	319.7	461.6	570.5	703.6
Consumer Goods	22.9	14.1	16.2	21.8	35.7	78.8
Total Imports	560.3	404.4	463.4	716.4	993.0	1,445.0
Total Less Grains	453.1	343.6	409.0	655.1	916.4	1,315.6
Gross National Products, 1965 Prices (In ₩ billions)	693.0	750.3	805.9	913.8	995.2	1,127.3

Classification

Grain: SITC 04

Capital Goods: SITC 7

Raw Materials: SITC 2. 3. 4. 5. 6.

Consumer Goods:SITC 0 Exemption 04; 1. 8. 9.

Source: EPB

TABLE 2

TAX EXEMPTIONS AND INTEREST PREFERENCE FOR EXPORTERS
1965 - 1968

	Direct Tax	Indirect Tax	Custom Duties	Total Tax & Customs Exemption	Interest Preference	Tax Exemption Plus Interest Preference	Total Export ($ mil.)
Total in Million Won							
1965	373	2,465	2,692	5,530	1,135	6,665	175.0
1966	566	4,455	5,333	10,354	2,232	12,586	250.3
1967	1,663	6,064	8,224	15,952	4,347	20,299	320.2
1968	1,463	9,664	19,261	30,388	6,861	37,249	455.2
Won Per Dollar of Exports							
1965	2.1	14.1	15.4	31.6	6.5	38.1	
1966	2.3	17.8	21.3	41.4	8.9	50.3	
1967	5.3	18.9	25.7	49.8	13.6	63.4	
1968	3.2	21.2	42.3	66.7	15.1	81.8	

Source: MOF

TABLE 3

EFFECTIVE EXCHANGE RATES FOR EXPORTS AND IMPORTS
1965 - 1968

(Won per dollar)

Export Rate	Exchange Rate	Tax Exemption	Interest Preference	Effective Rate On Export	Index
1965	265.4	31.6	6.5	303.5	100.0
1966	271.3	41.4	8.9	321.6	105.9
1967	270.7	49.8	13.6	334.1	111.0
1968	276.6	66.7	15.1	358.4	118.0

Import Rate	Exchange Rate	Custom Duties		Exchange Rate Plus			
		Collection	Exemption	Customs Collection	Index	Collections & Exemptions	Index
1965	265.4	27.1	20.9	292.5	100.0	313.4	100.0
1966	271.3	24.6	28.3	295.9	101.1	324.2	103.4
1967	270.7	25.5	32.5	296.2	101.2	328.7	104.8
1968	276.6	25.1	45.2	301.7	103.0	346.9	110.6

Wholesale Price Index

1965	100.0
1966	108.8
1967	115.8
1968	125.2

the combined value of these measures to the exchange rate, the adjusted rate is shown to have risen from 303.5 won in 1965 to 358.4 won in 1968. The export-import link system and the allowed wastage on duty-free imported materials have further increased earnings from exports and the 12.7-won figure shown in a study of the Korean Trade Association for the average value of these subsidies to the 30 largest exporters is likely to be on the low side. Calculating with 16.4 won, the Korean Productivity Center's estimate for 1967, we find that exporters on the average received 375 won for a dollar of foreign exchange receipt, i.e., 24% higher than in 1965 (Table 3).

17. The increase in the adjusted exchange rate for exports thus approximately equalled the 25% rise in domestic wholesale prices between 1965 and 1968. But the prices of imported materials, intermediate products and capital goods used in producing exports changed little during the period. Thus, increases in wages notwithstanding, the profitability of exports may have improved. While the study of the Korean Trade Association does not show such a result, it seems to have underestimated the value of tax and customs exemptions.

18. By contrast, the profitability of import-competing industries appears to have declined since 1965. For one thing, the domestic prices of these goods have increased much less than wages; for another, commodities destined for domestic markets use to a large extent home-produced rather than imported materials, and the prices of these materials have risen pari passu with the increase in the general price level.

19. The competitiveness of import substitutes has further suffered as a result of the trade liberalization measures introduced after the 1964 reform. The number of items on the prohibited and the restricted lists was reduced and, subsequently, the so-called negative list was established under which commodities whose imports are neither restricted nor prohibited automatically receive import licenses. It also appears that duties were reduced somewhat at the time of the 1967 tariff reform. As a result, the import exchange rate adjusted for duties and duty exemptions increased by only 11%, from 313 won in 1965 to 347 won in 1968, while domestic prices rose by 25%.

20. However, as imports increased, some of the restrictions have been reimposed, first in consumer luxuries and later on in commodities on the ECAFE list of less essential imports. Tariffs on some

commodities have also been increased, and since July 1968, advance deposits have been applied on most commodities with duties exceeding 50%. Thus, while the competitiveness of import substitutes is likely to have suffered on the average, a few industries have received increased protection. In turn, the low exchange rate has discouraged the domestic production of raw materials, intermediate products, and machinery that are presently imported.

Policy Recommendations for the Short Term

21. From the foregoing, it appears that the rapid growth of manufacturing and of investment activity have contributed to higher imports, both directly through the increased need for raw materials, intermediate products and machinery, and indirectly as a result of increases in wages and domestic prices. This tendency, together with the Government's desire to avoid the depreciation of the exchange rate in the face of rising domestic costs and prices, have necessitated the application of a variety of measures to stimulate exports and to restrain imports. But these measures have not been sufficient to attain the planned increase in the ratio of merchandise exports to imports; rather, this ratio has declined continuously in recent years. The ensuing deficit in the trade balance ($836 million in 1968 at f.o.b. prices) has been financed to a large extent by commercial loans and by foreign exchange receipts connected with the Vietnam war.

22. Continued reliance on commercial loans to finance large balance of payments deficits is hardly conceivable; however, since interest charges and repayment obligations necessitate ever-increasing amounts of a gross inflow to maintain a net inflow of foreign capital. Thus, while in the first year of borrowing, the net inflow of funds equals the gross inflow, after ten years the maintenance of a net inflow of, e.g., $100 million would require a gross inflow of over half-a-billion dollars. An additional consideration is that Vietnam-related receipts are not likely to continue at present rates.

23. There is need, therefore, for reducing the deficit in the Korean trade balance much below the one billion dollar figure expected for 1969. EPB projections envisage a decrease in the deficit in subsequent years, but these estimates assume a considerable decrease in the rate of imports to GNP, although imports increased much more rapidly in recent years. Under the continuation of present policies,

it is more likely that the deficit will continue to widen, and Korea may again face the painful prospect of applying deflationary measures as in 1963.

24. Changes in policies would be necessary to avoid such a situation. Two kinds of changes are suggested here: a slowdown in the process of economic growth and the devaluation of the currency. Lower than present growth rates (9% a year) are indeed projected for the period of the Third Five-Year Plan, but rates of expansion would have to be reduced much earlier in order to avoid a widening of the balance of payments deficit that would necessitate the application of restrictive measures, and possibly bring a temporary halt in the growth process. Indications are that rapid action is required, both by the use of fiscal and monetary measures, to avoid a further acceleration of wage and price increases and a balance of payments crisis that the 15% growth rate projected for 1969 may lead to.

25. In order to reduce the deficit in the balance of payments, there is further need for a devaluation of the exchange rate. The devaluation would remedy the deterioration of the competitiveness of domestic industry due to wage and price increases in recent years, and would also contribute to higher profit margins. The devaluation would benefit import substitution more than exports, since the domestic content of the former exceeds that of the latter. It would give inducement especially to import substitution in materials and intermediate products which has been penalized by the low exchange rate.

26. It should be emphasized that a devaluation would not adversely affect the position of the borrowers of foreign capital because they gain more through higher export prices than what they lose through larger repayments in terms of domestic currency. It is, however, opposed by these borrowers who prefer a continuation of the policy of increasing the domestic price of exports through subsidies to devaluation, since subsidies do not affect the cost of loan repayment. Yet higher repayment costs would only partly offset the advantages of these firms over firms that borrow domestically so that such a change would reduce existing inequities. At any rate, it is contrary to the public interest to permit the further proliferation of export subsidies which would be necessary to offset the effects of continuing domestic inflation in the absence of a devaluation.

27. A devaluation would also lessen existing pressures for further import restrictions. Proposed import restrictions on luxury goods would provide inducements for the domestic production of such commodities and assure high profits for their producers. It is suggested instead to raise taxes on luxury goods, including those produced domestically. Such taxes would tend to reduce the demand for luxuries, improve the distribution of income, and contribute to higher savings.

Policy Recommendations for the Longer Term: The System of Protection

28. The short-term recommendation of a devaluation can be linked with the longer term problem of revamping Korea's policies on exchange rates, tariffs, and export subsidies. We have seen that in maintaining the exchange rate virtually constant, the Government had to have recourse to a variety of measures aimed at bolstering exports and limiting imports. These measures have been introduced in a piecemeal fashion, and little is known of their joint effects on resource allocation and profits. At any rate, it is difficult to gauge the effects of the various non-price measures, such as the export-import link system and import prohibitions.

29. It is apparent, nevertheless, that apart from those participating in the export-import link system, the main beneficiaries of the measures applied are export industries that rely to a considerable extent on imported raw materials, intermediate products and capital goods. This conclusion follows since such imports enjoy customs exemptions as well as interest rate preferences, and imported raw materials used in export industries also receive a wastage allowance. Export subsidies, expressed as a percentage of price, thus tend to be higher in industries where domestic value added is low, and the differences are further accentuated if the calculation is made on a value added basis which is the relevant consideration.

30. This result runs counter to the Government's announced intention of promoting exports with a high domestic content. By undervaluing imported inputs, it also contributes to the exportation of commodities where the domestic cost of foreign exchange earnings is high. According to a study prepared by the Korean Trade Research Center, for example, in the case of electrical machinery, the direct plus indirect domestic cost of earning a dollar through exports (the dollar value of exports less the foreign exchange cost of direct and indirect

imported inputs) exceeds 1,000 won as against an exchange rate of 282 won. In turn, a study of the Korean Traders Association shows that export subsidies are especially high on some low-cost items, such as plywood and knitted fabrics, while among high-cost products, fresh fish, iron ore, wallpaper, and cement receive relatively low subsidies.

31. These estimates are subject to considerable error and are of interest mainly because they indicate the haphazardness of the system of subsidies and the inefficiencies resulting from their application. Similar considerations apply to tariffs. Tariff data presented in a study by faculty members of Seoul National University, "Analysis of Korea's Import Substitution Industry", show commodities that utilize to a large extent imported inputs being relatively highly protected, while capital and skill-intensive goods receive less than average protection. But tariffs often play a secondary role in protecting imports, and the same study showed no correlation between the height of tariffs and the ratio of domestic to foreign prices.

32. The system of protection applied also imposes a large burden on the Government budget. Tax and customs exemptions on exports amounted to 30 billion won in 1968, while the budgetary effects of the export-import linkage system, together with the allowed wastage of imported materials and the subsidy provided in the form of preferential interest rate each cost another 6-7 billion. By comparison, total revenues in the 1968 general Government budget were 324 billion won, of which import duties amounted to 42 billion as against duty exemptions (including exemtpions on materials and capital goods used in export industries) of 70 billion. It should be added that the application of import permits, as well as that of export subsidies on a case-by-case basis, are also conducive to corruption.

33. To reduce the adverse effects of the system of protection, it is suggested here that the partial measures presently applied be replaced by general measures. This could be accomplished by adopting a higher exchange rate that would permit reducing, and ultimately eliminating, quantitative import restrictions and limiting the variety of aids to exports. Apart from the rebate of indirect taxes on material inputs used in export goods, which is not a genuine subsidy, the remaining export subsidies should be consolidated into one providing equal protection on value added in all export industries. The same principle is applicable to imports.

34. This scheme would have the advantage of providing approximately equal incentives to all industrial activities, thereby inducing specialization according to comparative advantage. It would especially help industries that use chiefly domestic goods since a devaluation would raise their costs to a lesser extent than for industries relying on imported inputs. Additional protection could be provided to infant industries in the form of tariffs and subsidies, but these should be given on a temporary basis.

35. Furthermore, the Government should assure that divergences between domestic and foreign prices be avoided in the future. In the absence of a slowdown in the rate of inflation, this objective can be accomplished by adopting a system of flexible exchange rates or devaluing in frequent intervals, as is done in several Latin American countries.

36. These recommendations provide general objectives for the policy of protection in Korea. Needless to say, the speed of progress toward these objectives will depend on political and other factors. The ideal solution would be if the extent of the devaluation recommended on the basis of short-term balance of payment considerations were such as to permit reforming the system of protection. Should this not be possible, a temporary solution might be to unify export subsidies and to replace quantitative import restrictions by an import surtax. The latter measure would have to be extended, however, to industrial materials and machinery so as to avoid providing incentives for the use of these imports.

Policy Recommendations for the Longer Term: The System of Planning

37. By avoiding a divergence between domestic and foreign prices, Korea can ensure that the balance of payments deficits in the Third Five-Year Plan do not exceed the expected net foreign capital inflow. This statement reflects the view that the Korean economy possesses sufficient flexibility to reallocate resources in response to price incentives, i.e., exports and the production of import-competing goods will increase if the domestic value of foreign currencies rises relative to movements of domestic prices and vice versa.

38. In other words, while the foreign exchange gap is dominant in many underdeveloped countries where the transformation of domestic savings into investment via exports and import substitution encounters

difficulties, in its present state of development Korea could avoid this problem. In this respect, then, Korea would resemble developed countries, such as France and Norway, where projections of imports and exports are of little importance, and balance of payments equilibrium is ensured through exchange rate changes.

39. In this connection, it should be noted that the fear of increases in the share of exports and imports in GNP is largely unwarranted. It is the share of net rather than gross exports (imports) that is relevant, since Korea, being poor in natural resources, has to rely on the processing of imported materials that raise the rate of gross exports (imports) to GNP. Also, if Korea increasingly engages in subcontracting as suggested below, gross trade shares will rise to a considerable extent, but increases in net shares will be much smaller.

40. A corollary of this view is that participation in the international division of the production process reduces the usefulness of projecting gross exports and imports. Moreover, as partial measures and quantitative targets are increasingly replaced by price incentives, there is need for a change in emphasis in planning, with increasing attention given to limitations of domestic resources, i.e., the availability of capital and labor.

41. We have noted that the share of foreign saving in domestic investments has risen in recent years and that its present share in gross investment cannot be maintained. High levels of investment thus necessitate increasing the rate of saving. The Third Five-Year Plan envisages such an increase and calculates with a marginal saving ratio of 30%. To attain such a high ratio, appropriate policies will have to be devised, especially in view of the relatively poor record of private saving in recent years.

42. The private saving ratio (private saving as a proportion of disposable income after taxes) has declined from a peak of 14% in 1966, and the marginal ratio hardly has exceed 12% in 1968. To remedy the situation, it would be necessary to take measures that would ensure raising the rate of public as well as private saving and channeling these funds into investment. The need for higher capital/labor ratios to increase productivity underlines the importance of these objectives.

43. It is suggested here that EPB undertake a study on the determinants of saving, the role of financial intermediaries, and the

possibilities for self-financing. The EPB should also advise the Deputy Prime Minister on the desirability of raising public saving through increased taxation, as well as on the possible need of establishing new financial institutions, or transforming old ones, in order to improve the channeling of savings into investment. Finally, in the Third Five-Year Plan, several variants should be worked out based on different assumptions concerning saving by farmers, individuals, business and government.

44. Emphasis need further be given to the availability of labor, skilled and unskilled, for manufacturing industry and the tertiary sector. In the past, this labor was provided from the ranks of the unemployed and underemployed as well as from agriculture. Shortages of skilled labor have arisen in recent years and the rapid growth of urban employment has also impinged on the supply of unskilled labor. But while these imbalances have been mainly of a short-term character, in the period of the Third Five-Year Plan a more permanent shortage of labor may develop unless appropriate measures are taken to alleviate it.

45. Agriculture being an important source of labor for manufacturing and the tertiary sector, considerable emphasis should be given to raising agricultural productivity. Such a policy, involving mechanization and the provision of fertilizer and lime, would further serve the desired objective of reducing urban-rural income differences. The provision of adequate housing in urban areas would also encourage the transfer of labor while increased opportunities provided for labor training can assure an adequate supply of skilled workers. The latter purpose could be served by raising the amount of subsidy to firms engaged in labor training.

Some Implications of the Policy Recommendations

46. The application of these policy recommendations would entail the increased use of the price incentives and a lessening of Government intervention in private industry. Increased reliance was based on the market mechanism immediately following the 1964 reform. But in recent years, Government intervention has been on the increase, in large part because of the application of special measures in lieu of devaluation.

47. With the increased sophistication of an industrializing economy, however, direct measures become increasingly inadequate in economic policy-making. This has been understood even in socialist countries, such as Hungary and Czechoslovakia, which try to introduce price incentives and decentralize decision-making. In Korea, there is need to reverse the tendency of Government intervention in private industry, and to increase reliance on market forces.

48. Greater reliance on price incentives would contribute to specialization according to comparative advantage and thus ensure reducing the domestic cost of earning or saving foreign exchange. The lessening of Government intervention and the replacement of special measures by general provisions would also decrease uncertainty in private industry and reduce the effort necessary to comply with present regulations. The growth performance of the Korean economy would benefit as a result.

49. It is not suggested that the Government abdicate its responsibilities in developing basic industries. It has to provide overhead facilities and to decide on bulky investments, such as the steel plant, where the risk and uncertainties involved are likely to preclude private investments. But such decisions should also be made on the basis of economic calculus. Furthermore, special incentives to infant industries, such as machinery and equipment, should be provided on an across-the-board basis rather than benefiting one firm at the expense of others. Such incentives should be given for a limited time period and on a digressive scale, determined in advance.

50. While avoiding intervention in the affairs of individual firms, it would be useful if the EPB would organize industry committees with the participation of government, private business, and the banks to discuss trends of industrial development in the period of the Third Five-Year Plan, with special attention to the interdependence of industries and their export prospects. In the case of standardized products, forecasts should be made on market possibilities abroad. In other industries, projections are increasingly difficult but the Government could help in sponsoring market studies, trade fairs, etc. Studies on the comparative advantage of individual industries can also be helpful; such studies would be carried out under my supervision for the EPB.

51. Moreover, Korea should utilize its possibilities for participating in the international division of the production process by way of subcontracting. Subcontracting ensures markets for domestic products and also brings in foreign technology. The proposed establishment of a free trade port represents an important step in this direction, but further measures would have to be taken to encourage the expansion of subcontracting.

52. Export possibilities are also related to the policy followed concerning direct foreign investment. Such investments offer advantage to Korea by making available foreign capital, technological know-how, and market information. Nevertheless, in order to avoid the alienation of important branches of industries, it would be desirable to follow a policy of joint ownership, which has been applied with much success in Mexico.

FORM NO. 58 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: October 23 1969

FROM: Irving S. Friedman

SUBJECT: Doxiadis-SDC Ekistics Applications Program

You may find this of interest.

ISF

cc: Mr. Wm. Clark

President has seen

OCT 24 1969 - Returned 4 p.m.

FORM No. 57 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Andrew Kamarck

DATE: October 17, 1969

FROM: Koichi Mera, Economics of Urbanization Division KM

OCT 20 1969

SUBJECT: Doxiadis-SDC Ekistics Applications Program

1. I attended a Doxiadis-System Development Corporation Ekistics Applications Program on Thursday 9 and Saturday 11 October in accordance with your decision on Mr. Westebbe's memorandum of October 2. Mr. William Clark was also present.

2. This particular program was tailored to chief executives and senior management concerned with urban problems in the U.S.A. I have made the following assessments on the desirability of the Bank Group's involvement with the Doxiadis-SDC Program on the basis of my attendance at the Program and my reading of the outline of the program they have proposed for the IDB.

Evaluation

3. Dr. C.A. Doxiadis was able to assemble first-rate speakers in relevant fields: Every significant field relating to urban planning was covered, including geography, anthropology, city planning, technology, business and government.

4. Although the program provided provocative talks from invited speakers on social and institutional problems, the core presentation by the Doxiadis-SDC group was confined to physical planning. The process of arriving at a planning solution for a particular city (in this case the Detroit metropolitan area) was presented as an illustration. Social and political considerations were mentioned. But, the plan, which is typically physical, did not reflect deeper thoughts on socio-economic-political considerations. For example, the plan presented the distribution of population density over the area, but did not specify which people would live where and did not adequately cover how economic and social incentives could be used so that such a pattern of density could be achieved.

5. The process of arriving at a solution was presented, in my view, in a dishonest way. Because of the nature of the problem many decisions must rely on subjective value judgment and imperfect knowledge. But this was not presented explicitly. Instead, the Doxiadis-SDC people presented the case with such preliminary remarks as "The analysis told us that..." or "The computer gave us the following answer ...".

6. A three-day program such as the one given by the Doxiadis-SDC is a useful and effective introduction to urbanization problems and analysis for chief executives.

7. However, there is no need to have the Doxiadis-SDC organize the program. There are a number of alternatives open as to how such a program would be organized and by whom. What is essential is to have first-rate speakers on the subjects selected.

8. For junior staff directly involved in urban problems, I would not recommend a program such as the one proposed for IDB. This is because the fundamental techniques and methods of analysis to be presented are already well known to the junior staff and any additional techniques and methods that might be learned would be of doubtful usefulness for the Bank Group, i.e., an over-reliance on sophisticated analysis methods such as systems analysis and excessive orientation to physical problems as opposed to economic problems.

KMera:bhn

cc: Mr. W. Clark (through Mr. A. Kamarck)
Mr. R. Westebbe

FORM No. 57 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara   DATE: October 24 1969

FROM: Irving S. Friedman

SUBJECT: The Fund's Reserves

The Fund maintains a General Reserve and a Special Reserve.

Special Reserve:

The Special Reserve was created in response to the chronic problem which the Fund had in the first decade of its existence of a net loss in each fiscal year except 1948 because of administrative expenses. In 1956 it was decided to sell the equivalent of approximately $200 million in gold to the U.S. for dollars and to invest the proceeds in U.S. Treasury bills. Subsequently this authorization was extended to investment in longer-term U.S. securities. The income from this investment made it possible for the Fund to eliminate its accumulated deficit by November 1957. However, the Executive Directors of the Fund decided, in 1957, to provide a reserve towards meeting possible future deficits of the same character as that for which the program had been undertaken in the first place, namely administrative deficits. The decision was rather general in that it stipulated that the amount of gold sold for investment would be such as to produce an amount of income reasonably related to the purpose of the investment. Any administrative deficit for any fiscal year of the Fund is to be written off as against this Special Reserve. The investment was increased over time and reached $800 million in 1960. As of September 30, 1969 the balance in the Special Reserve amounted to $331,393,782.

General Reserve:

After the elimination of the Fund's cumulative deficit, the Fund established a General Reserve to which its net income for any year could be placed. In accordance with the Fund's request the Board of Governors must determine annually what part of the Fund's net income shall be placed to reserve and what, if any, shall be distributed. For each fiscal year from 1958 through 1967 the Fund's net income was placed to the General Reserve. For fiscal years 1968 and 1969 part of the year's net income was allocated to the General Reserve and the remainder was distributed to member countries at the rate of 1½% of the amount by which the Fund's holdings of member country's currency during the relevant fiscal year was less than 75% of a member's quota. In effect this meant a distribution to those countries which were the equivalent of creditor countries in the Fund, because their currencies had been used to make Fund transactions. In the terms of the Fund these were countries with super-gold tranche drawings. When the Fund established the General Reserve it did not adopt any decisions specifying the use to which it could be put. As of April 30, 1969 the balance of the General Reserve amounted to $324,646,839. With the provisional addition of net income for the five months ending September 30, 1969, the balance in the General Reserve amounted to $350,944,131.

Under the amended Articles of the Fund the Board of Governors will have the authority to transfer to the General Reserve all or part of the Special Reserve.

The question as to the uses to which the General Reserve might be used in the future remains largely a question of policy as well as law. In this connection it might be noted that losses of a capital or principal character could theoretically be charged against the General Reserve, but realistic examples of such losses are difficult to imagine since the relation between the Fund and the members is calculated in terms of gold and each member is obliged to maintain the value of the Fund's holdings of its currency in terms of gold. Thus, at any time, the Fund is automatically guaranteed against losses resulting from currency depreciation or devaluation. Even when a borrowing or "drawing" country does not repurchase its own currency and replaces it with other currencies, the Fund continues to hold the currency of the original purchasing member, and thus, because of the gold equivalent guarantee, its total assets remain unchanged.

This note was prepared in consultation with Fund staff.

May I add the thought it is quite possible that part of this General Reserve could be invested in World Bank bonds. Presumably the Fund could be influenced by the liquidity of such bonds and the existence of a gold equivalent guarantee. The Fund's assets are completely fungible since they consist of currencies derived from a multitude of transactions including original contributions.

FORM NO. 57 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara **DATE:** October 24 1969

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Special Reserve:

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largely

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This note was prepared in consultation with Fund staff.

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identifiable as

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D R A F T

To: Mr. Robert S. McNamara

From: Irving S. Friedman

Subject: The Fund's Reserves

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Special Reserve:

The Special Reserve was created in response to the chronic problem which the Fund had in the first decade of its existence ~~of its existence~~ of a net loss in each fiscal year except 1948 because of administrative expenses. In 1956 it was decided to sell the equivalent of approximately $200 million in gold to the U.S. for dollars and to invest the proceeds in U.S. Treasury Bills. Subsequently this authorization was extended to investment in longer term U.S. securities. The income from this investment made it possible for the Fund to eliminate its accumulated deficit by November 1957. However, the Executive Directors of the Fund decided, in 1957, to provide a reserve towards meeting possible future deficits of the same character as that for which the program had been undertaken in the first place, namely administrative deficits. The decision was rather general in that it stipulated that the amount of gold sold for investment would be such as to produce an amount of income reasonably related to the purpose of the investment. Any administrative deficit for any fiscal year of the Fund is to be written off as against this Special Reserve. The investment was increased over time and reached $800 million in 1960. As of September 30, 1969 the balance in the Special Reserve amounted to $331,393,782.

General Reserve

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Under the amended Articles of the Fund the Board of Governors will have the authority to transfer to the General Reserve all or part of the Special Reserve. # ~~However~~, The question as to the use to which the General Reserve might be used for the future remains a question of policy. In this connection it might be noted that losses of a capital or principal character could theorectically be charged against the General Reserve, but realistic examples of such losses are difficult to imagine since the relation between the Fund and the members is calculated in terms of gold and each members is ~~are~~ obliged to maintain the value of the Fund's holdings of to currency ~~currencies~~ in terms of gold. Thus, at any time, the Fund is automatically guaranteed against losses resulting from ~~deflation~~ currency depreciation or devaluation. Even when a member country does not repurchase, the ~~country~~ Fund continues to hold the currencies of the country's original purchasing member, and thus, its total assets remain unchanged.

borrowing or "drawing"

its own currency and replace it with other currencies

This note was prepared in consultation with Fund staff.

Mr. Gold

October 23,
1969

Philine R. Lachman

The Fund's Reserves

The Fund maintains a General Reserve and a Special Reserve. After a succinct description of their historical origin, this note describes the uses to which the reserves may be put in the light of the rules which have hitherto been applied.

1. From the beginning of the Fund's operations up to April 30, 1956, the Fund had a net loss in each fiscal year except 1948. As of April 30, 1956, the net cumulative loss amounted to $14.21 million. On January 25, 1956 the Executive Directors of the Fund adopted a decision 1/ regarding "Investment of Fund's Assets", in which they observed that the Fund had had, and might continue to have, an excess of expenditure over income, and held that in the interest of the administration and conservation of the Fund's resources, it would be appropriate to raise income toward meeting the deficit. This would be achieved by the investment of a portion of the Fund's gold in such a manner that the Fund would be able to reacquire the same amount of gold at any time. The amount of the investment would not be such as to limit the ability of the Fund to make its resources available to members, while at the same time producing an amount of income reasonably related to the Fund's deficit. As the greater part of the Fund's administrative deficit had been and would continue to be in U.S. dollars, the decision provided for the sale of the equivalent of approximately $200 million in gold to the United States for dollars and the investment of the proceeds in U.S. Treasury Bills having not more than 93 days to run. 2/ The income from this investment was used to reduce the accumulated deficit, which was eliminated by November 1957. After the elimination of the deficit the Executive Directors amplified the original decision 3/ in order to provide a reserve toward meeting possible future deficits of the same character as that for which the program had been undertaken in the first place. The latter decision stipulated that the amount of gold sold for investment would be such as to produce an amount of income reasonably related to the purpose of the investment. It also provided that the income from the investment earned after October 31, 1957 would be placed to a Special Reserve and that any administrative deficit for any fiscal year of the Fund would be written off first against this reserve.

1/ Decision No. 488-(56/5), Selected Decisions, Third Issue, pages 112-114.

2/ Subsequently, this authorization was extended to investment in longer term U.S. Treasury securities.

3/ Decision No. 708-(57/57), November 27, 1957, Selected Decisions, Third Issue, pages 114,115.

The investment was increased from \$200 million to \$500 million in 1959 and to \$800 million in 1960. As of September 30, 1969 the balance in the Special Reserve amounted to \$331,393,782.

2. After the elimination of the Fund's cumulative deficit, the Fund established a General Reserve to which its net income for any year could be placed. Pursuant to Article XII, Section 6(a) of the Fund's Articles, the Board of Governors must determine annually what part of the Fund's net income shall be placed to reserve and what part, if any, shall be distributed. For each fiscal year from 1958 through 1967, the Executive Directors recommended to the Board of Governors, and the Governors resolved, that the Fund's net income be placed to the General Reserve. For fiscal years 1968 and 1969 the Executive Directors recommended, and the Board of Governors resolved, that part of the year's net income be allocated to the General Reserve and that the remainder be distributed to member countries at the rate of 1-1/2 per cent on the amount by which 75 per cent of each member's quota had exceeded the average of the Fund's holdings of the member's currency during the relevant fiscal year. When the Fund established the General Reserve it did not adopt any decision specifying the uses to which it could be put. General principles would apply in this respect.

As of April 30, 1969 the balance in the General Reserve amounted to \$324,646,839. As the power to determine the distribution of the net income of the Fund is reserved to the Board of Governors, the Fund's net income is transferred provisionally to the General Reserve pending action by the Board of Governors annually. With the provisional addition of net income for the five months ending September 30, 1969, the balance in the General Reserve amounted to \$350,944,131 on that date.

3. From what has been said in paragraph (1) above, it is clear that the use envisaged for the Special Reserve at its establishment was clearly defined as being limited to providing a reserve toward meeting possible future administrative deficits of the Fund. In line with this limited purpose, the income of the investment is transferred directly to the Special Reserve when received and does not enter into the Fund's net income for the purpose of the provision of the Articles which authorizes the Board of Governors to place net income to reserve or distribute it among member countries in accordance with stated rules. The legal reasoning which led to the establishment of the investment program would not justify investment as part of the substantive operations of the Fund or in order to raise income for the general purposes of the Fund. It would therefore not be possible to distribute the income of the investment or the Special Reserve under the provision governing distribution of net income. Under the amended Articles the Board of Governors will be able to transfer to General Reserve all or part of the Special Reserve. As the yield of the Fund's investment does not constitute net income for the purpose of the provisions relating to the distribution of net income, amounts of the Special Reserve transferred to the General Reserve cannot be distributed under these provisions. Amounts transferred from Special to General Reserve will, however, be available to meet deficits of any

character, whether operational or administrative, including deficits resulting from the payment of remuneration to members in accordance with the Fund's amended Articles (Article V, Section 9).

With respect to the General Reserve, generally accepted principles would indicate that this Reserve could be used to deal with contingencies and, in fact, various minor charges which could be classified in that way have been made against the General Reserve. Losses of a capital or principal character could be charged against the General Reserve but realistic examples of such losses are difficult to imagine since the relation between the Fund and its members is calculated in terms of gold. If there are any losses of whatever character leading to administrative deficits, they would be charged first against the Special Reserve and only after the exhaustion of that reserve would these deficits be charged against the General Reserve.

Form No. 57 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Personal and Confidential

TO: Mr. Robert S. McNamara

DATE: October 7, 1969

FROM: Irving S. Friedman

ISF

DECLASSIFIED
MAR 28 2013
WBG ARCHIVES

SUBJECT: Conversation with President, Asian Development Bank

I had a long personal conversation with Takeshi Watanabe and I would appreciate if these remarks were regarded as addressed only to you.

1. He has definitely decided not to accept re-appointment after the end of his term which expires in two years'. He had been debating leaving at this time but felt that this might be unfair to the Bank although he said he would prefer not to be there for personal reasons.

2. The Bank is getting started on making loans, as you know, but they are having trouble raising concessional money. He agreed that with the strengthening of the Japanese economy there might be hope in that direction because of the interest which the Japanese have in South East Asia.

3. On the positive side the staff work has finally begun to show some fruits, as a result of which, at least, they are beginning to have some basis for discussions with their Executive Board and decisions. On the other hand his Executive Directors simply do not have enough to do and are keenly conscious of the unwillingness of countries, particularly the United States Government, not to give them the same status in terms of salary, etc. as Executive Directors in the Fund, the Bank, or the Inter-American Bank.

4. The personal situation of the Executive Directors -- particularly their wives -- is one of boredom, unease, and frustration. The question of personal security has become such that no one feels safe even when protected by special guards. In his own case he has two guards with modern weapons protecting his household all the time but was not at all sure that these weapons would not be turned on his family at some point. There had been repeated instances of robbery and mugging, as well as kidnapping. The police cooperated with the gangsters. He also cited examples of where the police had been known to recover stolen goods but simply kept such goods without returning them to the original owners. Some wives of Executive Directors have simply left and refuse to stay with their husbands as long as they stay in Manila. Closely related is the problem of raising children in such an environment.

5. They are having great difficulty in constructing a building and even awarding contracts. The result is they are now housed in four separate buildings and moving from building to building in a tropical climate is cause for discontent to staff and others.

6. I believe that Watanabe has now been trying to recruit staff. The staff from India and Pakistan seem to be willing to accept these conditions but those from North America and other European countries are chronically

Returned
OCT 8 1969
(1 p.m.)

unhappy and wish to leave. Their salary structure and conditions are considerably below ours and basically unattractive. He appreciates that a good staff is basic for the future of his Bank. He is now trying to recruit more North American and European staff.

Before the Asian Development Bank had been formed Watanabe and I (as well as others, of course) had discussed at great length the question of location as well as the presidency. Conditions in the Philippines then were similar to those at present and these difficulties could be foreseen but they were part of the deal of having a Japanese president together with the headquarters in another country.

7. I believe that the Asian Development Bank can be a major instrument in softening the Japanese attitude towards providing concessional aid and indeed helping to facilitate more assistance to IDA. If the Asian Bank, which comes close to being the "chosen instrument" of the Japanese, fails, then we may see even greater emphasis on Japanese bilateralism. There is, naturally, a certain competitiveness between the Asian Bank and the World Bank, but underneath that competition I believe there is a more fundamental common interest, namely to bring Japan into the family of important aid givers. Japan has a sense of participation in the world shared by few countries and when they do something it tends to be done aggressively and efficiently.

It is for such reasons, as you know, that I have believed that our past approaches to the Japanese have been much too cautious. The amounts we are talking about now make much more sense. However, the failure of the Asian Development Bank could thrust Japan back into politically motivated or export orientated bilateralism as against educating the Japanese to the concept of development finance to provide assistance in the development process via multilateral channels.

FORM No. 57 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara DATE: October 2 1969

FROM: Irving S. Friedman

SUBJECT: 6% Growth Rate

Attached is a memorandum for your information on the 6% growth rate. There are a number of important policy questions raised by this, if we take the 6% target seriously. For example:

(i) The Area Departments (and the Economic Committee) could be asked to use the 6% growth rate as an operating criterion and direct their analysis and estimates as to what would be necessary in a particular country to get it to the 6% level -- accepting with all the obvious qualifications that any country that is already growing at 4% could reach the 6% rate by 1975 with the proper mix of national economic policies, investments and inflow of external finance and other resources.

(ii) We could decide to give priority in IDA allocations to countries that are below the 6% level compared to those over 6%, assuming that their economic performance was satisfactory, investment opportunities available and they were not purely "Bank" countries.

(iii) Those countries that are below 4% should be given special attention to diagnose their particular problems and to see whether special prescriptions are necessary. More thought will be given to this basic question of how to implement the average 6% target rate of growth.

ISF

Att:

FORM NO. 57 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Irving S. Friedman DATE: October 1, 1969

FROM: Andrew M. Kamarck

SUBJECT: Six Percent Growth Rate Target

In Mr. McNamara's address to the Board of Governors, he suggested that an increase in the growth rate of the developing countries "to a level of at least 6% is essential." This rate, 6%, also appears to be the rate that may be set as a minimum target in DD II. There may be queries as to how feasible such a growth rate may be. This is not an easy question to answer as one would have to establish a realistic set of assumptions, make a careful study of each country, etc. The following is a quick attempt to assemble some pertinent data, however. The 1960-68 growth rates of the 90 developing countries covered in our new mission plans and the forecasts for 1969-74 set down in our last five-year plan exercise are summarized in the following table:

Mission Classification of Countries	Rates of Growth in 1960/68 of		Bank 5-yr Plan Forecast Rates 1969/74		In Either Period	
	6% or more	4% or more	6% or more	4% or more	6% or more	4% or more
			(number of countries)			
"Annual"	8	22	9	22	12	27
"Biennial"	5	18	9	17	11	20
"Triennial"	7	14	3	12	9	20
Total	20	54	21	51	32	67

These figures show that 20 countries achieved a 6% rate or above in the 1960-68 period. If one takes a rate of 4% or higher as indicating that a country that has achieved such a rate should be within striking distance of a 6% growth rate, then the majority of countries, 54, were already there during 1960-68.

Forecasts were made for only 58 countries, unfortunately. Of these, 21 are forecast to grow at 6% or more and 51 at 4% or more. This is not a random sample of our 90 countries (the availability of forecasts may be greater for the more rapidly growing countries) and, consequently, one cannot necessarily assume it would be legitimate to extrapolate that 36% of the countries are expected to grow at 6% or more but clearly a step-up in the rate of growth is expected in the next five years.

More importantly, only 23 countries do not show a rate of growth of 4% or better in either of the two periods. As some of these are probably due to blank forecasts, a 6% rate of GDP growth as a minimum target to be achieved by a country during the 1970's, ceteris paribus, would not appear to be too unrealistic a target to set up for most countries. It should be noted that neither India nor Indonesia had reached the 4% level in 1960-68 and there are no forecasts for them.

AMK/vhw

Form No. 57

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

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: September 30 1969

FROM: Irving S. Friedman

SUBJECT: Possible Commodity Stabilization Resolution - African Caucus

Mr. Kochman informed me last night that he had done his best, and believed that he had succeeded, in convincing the French speaking African countries in their recent meeting in Paris not to introduce a Resolution at this Conference calling for further studies by the Bank etc., but instead to accept the decisions made as important forward steps going as far as the Bank could go and look to the Bank for the implementation of these decisions. This, he said, was the meaning of his cabled message to you.

He was optimistic but not certain that this view would prevail during the Conference. His viewpoint was that which he had told me he would take before he left for the Paris Conference.

This might affect your opening remarks to the African Caucus.

Mr. Robert S. McNamara September 30 1969

Irving S. Friedman

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This might affect your opening remarks to the African Caucus.

Daphne:

Please send immediately the following note to Mr McNamara

To: Mr McNamara
Fm: ~~Mr~~ Mr. Friedman
Subject: Possible Commodity Stabilization Resolution - African Caucus

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FORM NO. 57

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

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: September 22, 1969

FROM: Irving S. Friedman

SUBJECT: Study on Export Credits from LDC's

I believe you will be interested in seeing the attached memorandum summarizing very briefly our work on export credits which has extended over a number of years. Mr. Nespoulous-Neuville reports on his discussions with Lord Aldington who has been concerned with the Indian export credit problem. I also had occasion to exchange views with Lord Aldington on this matter a few months ago.

I am also attaching for your handy reference an earlier study on this matter. At that time we had more ambitious thoughts about what the Bank might do but it was decided to leave such thoughts out of the report because of other considerations, such as the then current IDA replenishment discussions.

ISF

President has seen

SEP 24 1969 - 10 a.m.
(Returned)

FORM NO. 57

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

OFFICE MEMORANDUM

TO: Mr. Irving Friedman

DATE: September 18, 1969

FROM: A. Nespoulous-Neuville *A. N. N.*

SEP 18 1969

SUBJECT: Study on export credits from LDC's

1. This note is in answer to your request on the present status of our study on export credits from developing countries.

2. The Bank was requested by UNCTAD I to work on suppliers' credit to and from LDC's. On suppliers' credits from LDC's, it submitted to UNCTAD II, on February 6, 1968, a brief report, indicating inter alia that further work would be postponed until the completion of a first stage, consisting in a full field evaluation of existing national export credit schemes existing in LDC's, which had been undertaken by the UN Secretariat. UNCTAD II requested the Bank, jointly with the UN Secretariat, to continue studying this problem.

3. The findings of the UN Secretariat, together with their proposals for action, were discussed at a Round Table in New York last March 24 to 28. It appeared to the representative of the Bank, as well as to those of insurance credit institutions in developed countries, that the UN Secretariat was too ambitious in its program of action /1 and disinclined to follow suggestions that it moderate its ambitions. In order to disassociate ourselves from the UN Secretariat on this matter, we made clear to them during the Round Table and again at the end of April in our comments on their report on the Round Table that the proposals they submitted to the Round Table were for their own action, and not for joint action between the UN and the Bank. We, of course, were glad to offer to continue our assistance.

4. A similar stand was taken by the Bank last July at the summer session of the Economic and Social Council. A resolution introduced by the UN Secretariat without prior consultation with the Bank invited the Bank "to study the possibility of guaranteeing medium and long-term export credits granted by LDC's for purpose of facilitating the financing of those credits on the international private capital market and to report to ECOSOC at its 49th session". Under instructions from Mr. Demuth, our representative at the ECOSOC session obtained that this invitation be reformulated, so that the UN Secretariat was asked to prepare this study "in consultation with the IBRD and the regional development banks".

5. Our position, as stated to the UN Round Table, is that our interest is limited to exports by LDC's of goods (such as capital goods) which are to be financed through medium-term and long-term export credits; although we are ready to advise the UN Secretariat on all aspects of this problem, including export credit insurance, we believe that it would be wiser and more effective to concentrate on export financing. We also stressed that it was first necessary to assess the magnitude of the problem, i.e. to what extent actual or potential exports are in fact hindered

1/ In particular the UN Secretariat intends to promote what seems to be an unworkable world-wide export-credit insurance institution.

by lack of credit or insurance facilities, and to what extent they are simply not competitive. The possible future role of the World Bank would depend on a number of important factors, among which are the conclusions of the current reassessment of its policy towards the industrialization of LDC's. Direct intervention of the Bank, through the use of its guarantee power, would require careful preliminary studies.

6. Work on this matter has been delayed since last April; the only staff member available for this purpose, Mr. Nespoulous-Neuville, was working nearly full time for the Europe, Middle-East and North-Africa Department, until last week. However, last June, Mr. Nespoulous-Neuville had the opportunity of discussing this problem, as concerns India, with the representative of the Indian delegate to the General Meeting of the Berne Union in Zurich, and with Lord Aldington, Chairman of the Board of National and Grindlays Bank in London, who is actively concerned with this matter.

7. Work on this problem has now been resumed and will be carried on in the Development Finance Studies Group on a continuing basis. The assistance of the area departments would speed it. We intend to discuss in the near future with the UN Secretariat our respective work programs and the assistance the UN Secretariat may expect from us for their own studies.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

January 20, 1967

SUPPLIERS' CREDITS from INDUSTRIALIZED to DEVELOPING COUNTRIES

A Study by the Staff of the World Bank

Requested by

United Nations Conference
on Trade and Development

SUPPLIERS' CREDITS from INDUSTRIALIZED to DEVELOPING COUNTRIES

A Study by the Staff of the World Bank

Requested by

United Nations Conference on Trade and Development

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT
WASHINGTON, D.C. 20433, U.S.A.

OFFICE OF THE PRESIDENT

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U Thant
Secretary-General of the United Nations
United Nations
New York

My dear Secretary-General:

I have the honor to transmit herewith a Study on Suppliers' Credits from Industrialized to Developing Countries, which has been prepared by the staff of the International Bank for Reconstruction and Development in response to Recommendation A-IV-14 adopted by the United Nations Conference on Trade and Development in June 1964.

The Study traces the growth of suppliers' credits as an important medium of international finance and examines the nature and causes of various problems which have arisen in their use, with special reference to effects on the debt situation of developing countries. It concludes with a series of recommendations for action by both the debtor and creditor countries.

I believe that these recommendations warrant careful consideration in view of their relevance to the orderly growth of developing countries, as well as to the stability of international trade and finance. In accordance with past practice in similar cases, this Study does not purport to represent the views of the Executive Directors of the Bank, or of the governments which appointed or elected them.

Sincerely yours,

George D. Woods

George D. Woods

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SUMMARY

This study 1/ by the staff of the International Bank for Reconstruction and Development was prepared in response to a resolution adopted at Geneva in 1964 by the United Nations Conference on Trade and Development. In accordance with the resolution, the report contains a discussion of the use of suppliers' credits and credit insurance as a means of financing imports by developing from developed countries. Difficulties which have arisen in connection with the use of these credits are identified, and some possible means of overcoming them are recommended.

Intermediate and longer term suppliers' credits constitute a relatively new form of international finance. Although the transactions involved are basically private, governments on both the creditor and the debtor side have played an increasing role in enhancing the importance of these credits, through guarantees and otherwise.

Governments of the "creditor" countries have supported or promoted guarantee and credit facilities, largely in response to pressures for assistance from their exporting sectors, and also to implement their policies of export promotion and diversification. In the process, they have helped to increase the transfer of resources to developing countries. Guarantee schemes established by "debtor" countries have encouraged the inflow of suppliers' credits, particularly when other sources of foreign capital have been limited. These arrangements have increased competition among sellers and progressively lengthened maturities, but sometimes they have also encouraged inadequate evaluation of the quality and economic merits of the projects financed.

Efforts to introduce restraints and harmonious practices at the national and international level have been made within the Union d'Assureurs des Credits Internationaux (Berne Union), the European Economic Community (EEC) and the Organization for Economic Cooperation and Development (OECD). Despite the progress towards understanding the problems involved, especially those resulting from the excessive indebtesness of some debtor countries, these efforts have not yet produced operative arrangements which could effectively cope with unfavorable aspects of suppliers' credit financing.

The growing importance of suppliers' credits, as a large component of capital flow to developing countries, is shown by the fact that at the end of 1965 total outstanding indebtedness on account of credits under guarantee approximated \$6 billion, or an estimated one-sixth of the total external indebtedness of such countries. Moreover,

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1/ It should be noted that this is a staff study and does not purport to represent the views of the Executive Directors of the International Bank for Reconstruction and Development, or of the Governments which appointed or elected them.

because of the shorter maturities of such credits, payments to service them represent a much higher proportion of the outstanding amount than the ratio of service payments to total debt.

Many economic, technical and political factors have contributed to the growing importance of suppliers' credits. In developing countries, industrialization policies have often been accompanied by markedly nationalistic and at times non-orthodox domestic financial, trade and exchange policies. These and other factors, combined with the specialized nature of projects, and frequently their small size, have tended to induce borrowers to turn to the most readily available sources of financing. In the capital exporting countries, the emergence of excess capacity to produce capital goods and more easily available financial resources have contributed to the growth of suppliers' credits, with the encouragement of the export and balance of payments policies of governments. Both in developing and industrialized countries, suppliers' credits have conveniently replaced private institutional and market financing, which had been disrupted by war and controls. In practice, other alternatives have not been readily accessible on a sufficient scale. This has been true of international institutional lending, not only because of its limited scope, but because its use has often been inhibited by the poor quality of many projects and the inadequate creditworthiness and unsatisfactory economic policies of potential borrowing countries.

A minority of the countries for which information is available made excessive use of suppliers' credits. On the debtor side, the main factors included highly protective practices - whether deliberate or not - associated with protracted inflationary policies; non-existent, limited or ineffective control by the authorities over the assumption of these credits; inadequate preoccupation of the central authorities with the economic soundness or the quality of the projects financed; inadequate debt management policies; and, in a few cases, active inducements to obtain suppliers' credits because of the practical unavailability of other foreign resources. On the creditor side, excessive granting of suppliers' credits resulted from emphasis on commercial and balance of payments policies; successful pressures on governments by various domestic sectoral interests; and an excessive reliance on the legal aspects of guarantees granted by the debtor countries. Inadequate knowledge of the indebtedness of receiving countries, and limited effectiveness of international cooperation among creditor countries, were contributing factors.

In a number of cases the use of suppliers' credits has involved costly consequences for the developing countries. The beneficial effects normally expected from competition among suppliers and from the guarantee schemes have not always materialized. In some cases, alternative sources of supply were unknown or practically inaccessible. In other cases the desire of the supplier to cover himself against risks not protected by the guarantees, or the absence of guarantees on either side, resulted in high effective interest costs. In a broader sense, there were costs in the form of distortions in the use of domestic resources, which frequently had an adverse effect on the receiving country's debt servicing capacity. Costs were also involved whenever the pressures on the balance of payments, generated by excessive indebtedness due to these credits and other loans, made rescheduling operations unavoidable. These debt crises had adverse effects on the creditworthiness of the countries concerned and thus on their access to foreign finance, including suppliers' credits.

One conclusion derived from the available evidence is that suppliers' credits have made a useful contribution to the flow of capital to developing countries and that they will continue to play a significant role as a form of finance, particularly in manufacturing industry. It also appears, however, that the effectiveness of these credits could be enhanced by arrangements aimed at preventing or minimizing improper uses. Creditor and debtor countries, as well as international organizations, have an important role to play in achieving this result.

An important precondition is the provision of adequate and reliable information on these credits and on the indebtedness of developing countries in general. A recent joint OECD-World Bank agreement for improvements in the reporting system of creditor countries should contribute to that end. Major progress, however, depends on the efforts of developing countries in providing information on their total indebtedness, the term structure of external debt, and the ulitization of suppliers' credit.

The pursuit of balanced foreign debt policies by developing countries, based on sound economic and financial policies, would minimize distortions in private decisions of their residents and enhance the preparedness of foreign governments or institutions to lend to them. Sound debt management requires judicious use of prior authorization procedures and budgetary controls on the contracting of suppliers' credits by private parties and credits by public or semi-public agencies. The aim should be to give top priority to sound economic projects, particularly those which improve the debt servicing capacity, and to assure that public sector projects are of sufficiently high quality to warrant international institutional financing. Developing countries could avail themselves of the opportunity they have, through their regular contacts with international organizations, to obtain technical assistance on these matters wherever possible.

It is desirable that creditor countries agree on suitable forums to strengthen their joint efforts towards (i) harmonizing commercial and financial practices and (ii) formulating more purposeful policies in respect of suppliers' credits within the framework of their foreign aid policy. In administering guarantee schemes, emphasis should be placed by creditor countries on the quality of the projects financed and on the impact of proposed credits on the total indebtedness and the debt servicing capacity of receiving countries.

Effective international coordination in regard to individual debtor countries would reduce certain costs and excesses which have resulted from the use of suppliers' credits in the past. To promote wider competition among suppliers, consideration could be given to the possibility that existing international organizations, which have experience in these matters, act as channels of information to their member countries on the interest of a developing country in receiving suppliers' credits for a particular project. Preventive action against the recurrence of debt crises could be undertaken through groups of creditors - either existing consortia or consultative groups, or ad hoc groups of the type of existing "clubs."

Two additional steps might be considered by creditor and debtor countries. Further studies in depth of the experience of individual countries with suppliers' credits should throw more light on the entire problem. In creditor countries, suitable arrangements might be considered which would aim at an appropriate separation of the financing and commercial aspects of the sales of capital goods, placing greater emphasis on the use of financial credits. This might tend to give the buyer a wider selection of suppliers, both within and among countries of origin.

I. ORIGIN AND SCOPE OF STUDY

This study has been prepared by the staff of the International Bank for Reconstruction and Development (World Bank) in response to a resolution adopted by the United Nations Conference on Trade and Development (UNCTAD) at its initial session held in Geneva in March-June, 1964. The UNCTAD resolution 1/ recommended that the Bank be invited, among other things,

> "to make a study of the use (actual and potential) and terms of suppliers' credits and credit insurance ... for financing exports from developed to developing countries, taking account of the capacity of the latter to repay and of other effects on their economies and balance of payments ... to identify the difficulties which arise or may arise, in particular as regards debt service, and to consider solutions ... (and) to submit the study to the United Nations ... together with any appropriate recommendations."

In addition to the role of suppliers' credits and credit insurance in financing exports from developed to developing countries, the Bank was invited under the resolution to consider their effects "on competition between the exports of developing and developed countries" and to consider such credits and credit insurance "as a means of financing trade between the developing countries." This second aspect of suppliers' credits is quite different in nature from the first. Suppliers' credits from developed countries to developing countries indeed affect not only competition between exports of the two types of countries in third markets, but also competition within the domestic markets of the developing countries themselves. The present report, for reasons of priority, limits itself to the problems involved in the use of suppliers' credits as a financial resource to augment the supply of goods from developed countries to the developing countries. The financing of sales, both domestically and for export, of the manufacturing industries of the developing countries is a broad subject to which the Bank pays constant attention in connection with its concern for the development of its member countries, but it has not been possible to include it within the scope of the present report.

The subject of suppliers' credits and their effects on the economies of developing countries has been a matter of continuing interest to the World Bank for many years. As early as September 1954, at the Ninth Annual Meeting of its Board of Governors in Washington, D.C., the President of the Bank recognized the usefulness of suppliers' credits. He noted, however, that a transition was in process from a sellers' to a buyers' market in the international availability of capital equipment, and observed that "a competitive race is developing among suppliers all over the world," taking the form "not only of

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1/ The full text of the resolution and of a related draft recommendation proposed by Spain and Tunisia are found in Annex I. No vote was taken on the latter recommendation, though the resolution, which was adopted without dissent, specified that the observations contained in it were to be taken into account.

competition in terms of price, quality, and delivery date, but also competition in the offer of medium-term suppliers' credits." He called attention particularly to certain unsound tendencies that were setting in: "Suppliers' credits, I need hardly say, are an appropriate type of international financing when applied to the proper transactions. But they can be misused and over-used, and there is some disturbing evidence that this is happening - too much credit given under the pressure of competition, sometimes on inappropriate terms and for the wrong purposes." Summarizing the undesirable effects of inappropriate and excessive use of such credits, the President of the Bank pointed out that "an excessive use of short or medium-term credit must necessarily diminish a country's access to long-term capital funds. In short, the indiscriminate use of credit of this kind may increase the costs of development, may interrupt the continuity of effort, may upset the balance of investment, and may make the goals of investment harder, and not easier, to reach."

In subsequent years, the importance of suppliers' credits as a form of international finance has increased considerably. From a broad international point of view, this has induced a large transfer of real resources from developed to developing countries and has made an important contribution to the economic growth of the latter, particularly in the industrial sectors. The increase in the total flow of short and medium-term credits was accompanied, however, by a number of undesirable features and consequences which have adversely affected not only a number of developing countries but also creditor countries. For various economic, political and institutional reasons, the assumption of debt on credits of this type has been distributed unevenly; in 1965 a relatively small group of debtor countries has accounted for a large proportion of the total. For some of these countries, refinancing arrangements have been necessary because of their excessive annual debt service obligations. In the process, their borrowing capacity has been encumbered, and the flow of suppliers' credits themselves has been subjected to limitations. In addition, in these and other debtor countries, the circumstances under which some suppliers' credits were contracted made them unduly costly in terms of distortions in the utilization of real domestic resources, as well as from the financial point of view. These developments have induced both debtor countries individually and creditor countries as groups to introduce certain restraints on a national or international basis, to mitigate such undesirable effects. These measures have not always been effective, however, or even fully implemented.

The guiding concept of the World Bank staff in examining the role of suppliers' credits can be stated simply: on the one hand, full advantage should be taken of the forces that impel the flow of such finance; at the same time, there is need to tailor this flow to the requirements of sound economic development and to the total flow of international capital and the debt situation of receiving countries.

The report considers first the nature and evolution of suppliers' credits. It then examines the purposes of the various facilities for granting and incurring such credits. It considers their advantages when properly used, and analyzes the problems arising from excesses and unsound practices. Finally, it makes certain recommendations aimed at mitigating the problems, while retaining the advantages of this type of international finance.

The report deals with certain substantive aspects of suppliers' credits on which adequate information is available. It also makes appropriate policy proposals, based on findings regarding the use of such credits in the context of the over-all capital flows from industrialized to developing countries. The preparation of this report has been closely coordinated with a related study by the United Nations (Export Credit and Development Financing, 67.II.D.1). That study provides an analytical and historical review of the nature and operations of existing national systems and international arrangements regarding the granting of export credit and credit insurance, and a discussion of the main problems involved in the use of these techniques for expanding the availability of foreign resources for development financing. Some parts of the United Nations' study have been incorporated in the appended annexes, which provide further details on certain aspects of questions dealt with more generally in the main part of the report:

Annex I - Text of the UNCTAD resolution on suppliers' credits and of the related recommendation proposed by Spain and Tunisia.

Annex II - Summary of statement on the general evolution of export credit and export credit insurance systems (from U.N. Document 67.II.D.1, "Export Credit and Development Financing").

Annex III - Summary of characteristics of export credit insurance and private export credit in various industrialized countries.

Annex IV - Account of institutions and arrangements for cooperation among creditor countries.

Annex V - Some aggregate statistics on suppliers' credits.

In carrying out the analysis for this study, the World Bank staff has had the benefit of studies and inquiries conducted by such international agencies as the Bank for International Settlements and the Organization for Economic Cooperation and Development, as well as the United Nations Secretariat. Several of the annexes draw heavily on materials available as a result of studies by these agencies.

II. MAIN FEATURES OF SUPPLIERS' CREDITS AND CREDIT INSURANCE AND THEIR EVOLUTION

Nature of Suppliers' Credits and Credit Insurance [1]

The concern of the UNCTAD resolution, in requesting a study of "suppliers' credits and credit insurance ... for financing exports from developed to developing countries," has been interpreted as relating to credits granted by private parties to finance exports, as well as with their official support through systems of special financing facilities and credit insurance. In essence, the credits arise in connection with the commercial sales activities of private parties. They are granted directly by suppliers in the developed countries to customers in the developing countries, which may be private parties or public or semi-public agencies. Such credits may, of course, be extended out of the resources of the suppliers themselves or out of funds borrowed by them from banks for their general business activity or for the specific export transactions involved. 2/

Although the transactions underlying suppliers' credits are normally carried out for business reasons, even where one of the two parties (particularly on the debtor side) is not a private entity, the public authorities in the countries concerned are usually associated with the credits in various ways. Broadly speaking, the degree of governmental participation in suppliers' credits has increased along with their growing importance as a form of international finance. On the creditor side, the interest of the public authorities and the measures they have adopted have been based essentially on commercial and balance of payments considerations. The interests of private suppliers in maintaining or improving their competitive positions abroad have frequently coincided with the broad objectives of export promotion, diversification and foreign payments policies of their governments. This has induced the adoption of various arrangements, either public or with government support, to augment the flow of exports financed by suppliers' credits. The most important are special export credit or

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1/ For fuller details, see Annex III.

2/ There is a different form of international finance, which in many respects is similar to suppliers' credits. In this case, the credit received by the purchaser in the developing country is granted by a private bank or financial institution in a developed country, rather than directly by the supplier. This form of finance, which has appeared recently, is usually referred to as "buyers' credits" or "financial credits." Because of the limited experience with these credits and the scarcity of information about the, they are not covered systematically in the main body of this report. Some of their institutional aspects, however are described in some detail in Annex III.

refinancing facilities, and export credit guarantee schemes. The need for the first category of facilities was felt especially when the national banking and financial systems were ill-equipped to finance this type of credit; the latter schemes have aimed basically at protecting the supplier against a variety of risks resulting from the fact that payment was on a term basis.

On the debtor side as well, government intervention in suppliers' credits has had a variety of purposes. On the one hand, limitations on the availability of foreign exchange required to make their economic development policies effective have induced governments to help their own residents obtain suppliers' credits by granting guarantees, both for the debt service in local currency and for the foreign exchange transfer. On the other hand, public authorities have sometimes introduced controls on suppliers' credits or required prior authorizations. This has been done to channel foreign resources into desired economic sectors, and to protect the balance of payments position by preventing the acceptance of unduly onerous conditions, particularly with respect to interest rates and repayment terms. Both controls and guarantees have been applied in varying degrees by different countries, and often by the same country at different times. The application of these arrangements has not always insured fulfillment of the purposes for which they have been introduced. Public authorities have intervened most directly in connection with suppliers' credits when an excessive debt burden has led to their rescheduling, because of the fact that the agreed refinancing arrangements have transformed the credits into government-to-government loans. Usually, limitations on the contraction of new suppliers' credits have also been agreed upon.

An important factor in the expansion of medium and long-term private export credits in a number of countries has been the availability of refinancing facilities provided by central banks or public institutions. 1/ In addition, public agencies in a number of countries provide joint financing with private firms for exports. In other cases, the blending of public and private initiative occurs through a mixing of resources from the two sectors in the same institution, which in turn may be public or private.

In addition to financing facilities, creditor countries have provided export credit insurance to cover non-commercial risks, such as the political risks sometimes characteristic of international transactions, as well as commercial risks. Export credit insurance may cover credits granted to finance certain services, as well as goods. The insurance policies may be specific, covering an individual transaction, or they may cover a certain segment of the total export business of the supplier. Although the exporter may be required to carry the risk of a small percentage of the credit for his own account, there has been a general and steady tendency to increase the percentage of credits which

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1/ See the section on Export Credits in Annex III.

may be covered by insurance. The proportion covered for political risks is generally higher than for commercial risks. The insurance may be granted directly to the supplier, in the case of a suppliers' credit. When a buyer's credit is involved, the insurance may be issued to a bank, whether the credit is extended to the supplier or directly to the foreign buyer. In general, there is considerable similarity in the export credit insurance procedures of the principal capital-exporting countries. There are greater differences in their systems of export credit itself, which are generally related to the characteristics of financial institutions, procedures, and markets in each country.

Evolution of the Facilities 1/

In the early 1950's, export credit maturities gradually increased to from four to five years, especially in various European countries including the United Kingdom, France, the Federal Republic of Germany, Italy, and Belgium. As previously indicated, the lengthening of maturities of private credits was assisted by the evolution of credit insurance facilities.

Starting about the middle of the 1950's, exporters exerted pressures on authorities in Western Europe to extend insurance coverage beyond five years so as to permit a corresponding increase in the maturities of export credits. These pressures from exporters reflected pressures they were receiving from clients in the developing countries, which intensified as a trend developed, chiefly in the United States and the United Kingdom, toward the tying of public credits to purchases in the respective creditor countries. The industrialized countries of continental Europe, whose public credit had also been tied to a large extent, responded to these pressures and made it possible to extend the maturities of private export credits. An understanding reached within the Berne Union to limit competition in export credits, by setting a five-year limit for insurance on such credits, was progressively relaxed. Buyers' credits, as distinct from suppliers' credits, were excluded from the five-year limitation; it was agreed that the five-year maturity could be counted from the date of delivery of equipment rather than from the date of contract; and the extent to which contracts eligible for insurance could be financed was expanded by lowering the down-payment requirements on the part of buyers.

The largest export credit insurance institution in the world is the official Export Credits Guarantee Department of the United Kingdom (ECGD), which insures about 30 percent of the total exports of that country to all destinations. 2/ The United Kingdom has pioneered

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1/ For details, see Annexes II, III and V.

2/ The characteristics of export credit insurance and private export credit in various industrialized countries are described in greater detail in Annex III.

in expanding the coverage of export credit insurance, up to 100 percent of credits in certain cases. Both commercial and non-commercial risks are covered in the same policies and by the same institution. Under such guarantees, private banks may lend for export transactions covered by such policies - up to 15 years, in some cases - and there are refinancing facilities at the Bank of England, of which no use so far has been made.

Private export credits in France are also liberally backed by official credit insurance systems and by rediscounting facilities, not only through various specialized official banking institutions, such as the Banque Francaise du Commerce Exterieur and the Credit National, but also by the Central Bank. All export credits with a maturity of more than two years may be insured. In addition, joint export financing by private and official banks helps in lengthening the maturities and lowering the interest rates on export credits.

There is a similar blending of private and public lending for export transactions in Germany, with an even greater preponderance of official participation. Export credit insurance supports the export financing operations of private commercial banks as well as of specialized institutions, one of which is private (the Ausfuhrkredit) while the other is public (the Kreditanstalt fur Wiederaufbau). The latter, to a substantial extent, also relies for its resources on funds raised in the private capital market.

Medium-term export credit insurance in Italy is provided by an autonomous official institution, the Istituto Nazionale delle Assicurazioni. A variety of credit institutions extend the actual export financing, some of which raise a considerable part of their funds in the private capital market.

Export credit insurance in Japan is provided by the Ministry of International Trade and Industry. Private bank credit has access to rediscounting facilities at the Export-Import Bank of Japan.

In the United States, since the early sixties there has been a gradual shift of some export financing from the public to the private sector, at first under insurance and guarantee arrangements, later under rediscount facilities promoted or established by the Export-Import Bank of Washington. Credit extended by the private sector usually carries the shorter maturities, while longer-term export financing is provided mainly by the public sector.

Organized International Cooperation 1/

As indicated earlier, the growing importance of suppliers' credits in the postwar period has also led to various forms of international cooperation in efforts to deal with problems involved in their use.

For the most part, these efforts have been of two types. Attempts have been made by creditors 2/ to reach agreement on principles to govern private credit and credit insurance which they extend to finance exports to developing countries in general. The main objectives have been (i) as far as possible, to avoid distortions of trade due to differences in terms of credit or to subsidies of insurance premiums, interest rates or prices; (ii) to keep in check the lengthening of maturities, since competition in this respect has been recognized in principle as self-defeating. The other type of cooperation has consisted of the formation of groups of particular creditors in connection with external debt situations of individual developing countries. With the more limited scope of this type of cooperation, its results have been more concrete. Arrangements worked out through these ad hoc groups have afforded some temporary relief in debt crises of individual debtor countries. Nevertheless, they have not resulted in comprehensive or enduring mechanisms for handling the complexities associated with private export credits in general.

The oldest institution through which it was sought to establish general principles is the Berne Union, which has concerned itself with rules to govern export credit insurance. This organization, consisting of 26 public and private export credit insurance institutions, has been useful mostly as a channel for the international exchange of information on practices in the field. It has achieved some success in restraining credit competition, but its effectiveness has been limited for various reasons. In the first place, it is not an organization of governments, whose policies in the last analysis determine the practices that are followed, and the "understandings" it has reached from time to time have not been binding. Japan, one of the principal sources of private export credits, is not represented. As has been indicated, the maturity ceiling of five years, which the Union established on private export credits that may be covered by insurance,

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1/ For details, see Annex IV.

2/ "Creditor" and "debtor" in this context refer to governments unless otherwise specified, even though the actual creditors and debtors may be private parties. Where possibilities of confusion exist, "debtor country(s)" and "creditor country(s)" will be used to designate the countries of residence of actual debtors and creditors under suppliers' credits.

was not observed in many instances because of pressure by debtor countries and the competitive response of creditor countries, which led to a lengthening of maturities. Another factor was the development of other forms of credits, such as blended private-public credits, which do not fall within the scope of the Union.

Early in the 1960's, governments turned their attention to the need for some harmonization of practices in the field. This effort took place within the six-member European Economic Community (EEC), and the 21-member Organization for Economic Cooperation and Development (OECD). The EEC established a coordinating group of its member countries and their credit insurance companies, to cover the field of credits as well as insurance. Agreement was reached on the principle that private export credits for developing countries could extend beyond five years in maturity. Despite efforts to improve coordination among members, however, the group has achieved little agreement on principles or rules to govern credits of longer duration. The EEC has been represented as a bloc, in the OECD, in addition to the individual representation of its six member countries, but they have had no greater success in crystallizing their views in this forum or in prevailing upon others to accept general principles.

The OECD has dealt with the subject of private export credits in two of its committees, the Trade Committee and the Development Assistance Committee (DAC), which have somewhat different vantage points. As yet, no definitive results have been achieved by either of these committees in providing a guide to the creditor countries, which constitute the membership of OECD, in their practices with respect to private export credit or credit insurance.

One specific proposal considered by the OECD has been a "neutral zone" scheme. It would set maximum repayment periods of five, eight and 10 years on commercial credits and guarantees, for particular categories of goods and particular countries, and a minimum maturity period of 15 years on aid credits. The "neutral zone" would consist of maturities in the range of 10-15 years, which would be eliminated in commercial credits and thereby would be virtually eliminated altogether. The working group of DAC reached no conclusion, and the proposal was referred to the Trade Committee. The group on export credits and credit guarantees, established by the Trade Committee, reviewed the proposal but found no consensus that it would represent a practical basis for international agreement. The group also devoted considerable time on a proposal for the establishment of an OECD information system for transactions exceeding five years duration under which members would, on request, inform each other regarding terms which they were prepared to offer, or support through guarantees or insurance, on export transactions and project loans of a commercial character. Members appear prepared in principle to adopt some such system, but significant questions of detail remain unresolved.

The second type of international cooperation mentioned above has taken place in connection with external debt crises which have occurred since the late 1950's in some of the debtor countries. To deal with such crises, informal debt rescheduling "clubs" have been constituted by the principal creditor countries involved, e.g., the "Paris Club" and "Hague Club" for rescheduling debt service payments by such countries as Argentina, Brazil, and Chile. In one case, that of Turkey, debt rescheduling was carried out through a more formal international consortium under OECD auspices. The resulting arrangements did not alleviate the payment obligations of individual debtors (whether private persons or public agencies), nor did they affect materially the private creditors involved. Instead, they reduced the transfer burden for the countries concerned, through agreements stipulating that a certain percentage of the payments made by the individual debtors would be transferred back to the "debtor country" by the Governments of the "creditor countries." As a counterpart of this debt burden relief, the agreements between the "debtor countries" and the assembled "creditors" included, among other things, limitations on the debtors' recourse to private export credits under certain minimum maturities, generally eight years, to be observed during certain periods of time, usually 18 months.

International institutions, especially the International Monetary Fund (IMF) and the World Bank, have contributed in various ways to the international cooperative efforts relating to individual developing countries. In some of the informal "club" arrangements, "third-party" analyses of the balance of payments prospects of debtor countries have been provided by these institutions - short-term analyses by the Fund and the longer-term development outlook by the Bank. In at least three cases, arrangements were made to channel through the IMF the debtor country's reports to creditor countries on its performance in living up to commitments involving limitations on the use of private export credits. Quite apart from debt rescheduling operations, the IMF has sometimes included limitations on the use of certain types of suppliers' credits in its stand-by agreements with particular countries. Some of the countries for which consultative groups have been formed, such as Nigeria, Sudan, Thailand, and Tunisia, have made considerable use of private export credits, the servicing of which represents a substantial proportion of their total external debt service payments.

III. THE GROWTH OF SUPPLIERS' CREDITS AND THE EMERGENCE OF SOME PROBLEMS

This chapter deals with certain major substantive aspects of the evolution of suppliers' credits, such as the factors affecting their use, and the problems that sometimes have arisen in connection with them. The considerations developed below are based on the actual experience with this form of export financing, as evidenced by the available factual and statistical information concerning suppliers' credits with a minimum maturity of one year. 1/ As noted in Annex V, the different sets of data used for this report present various gaps and difficulties of reconciliation. Other imperfections are also noted. 2/ Nevertheless, it was felt that, together with other available

1/ The choice of this minimum maturity is in line with the conventions adopted by the Bank in the data compiled by it on external indebtedness and by the OECD in its records on the flow of financial resources to the developing countries (See World Bank, Procedure for Reporting on External Debt, Washington, June 15, 1962; and OECD, The Flow of Financial Resources to Less Developed Countries, 1956-63, Paris, 1964.) Admittedly this does not coincide with the criteria followed in the limitative clauses of most of the actual rescheduling agreements, where the minimum maturity is 180 days. It is felt that from the statistical point of view, however, the discrepancy arising from this difference is a minor one and that credits between six months and one year are not likely to give rise to lasting indebtedness problems.

2/ For consistency reasons, the trade data are obtained from International Financial Statistics (IFS), published by the IMF; the foreign debt data are those compiled according to the Bank's criteria mentioned above. For some countries these data may differ, to a limited extent, from those compiled by various institutions, including the Bank, to serve specific purposes.

With regard to the debt statistical series on suppliers' credits, it should be noted in particular that they do not include: (a) suppliers' credits which are not guaranteed or which are guaranteed only by private or semi-public agencies; and (b) those which, having been rescheduled, have become a debt of the Treasury or of the Central Bank.

With regard to the use of exports as a measure of the debt service burden, it should be noted that where receipts from tourism or other current invisibles represent an important percentage of total current receipts (e.g. Mexico, Spain, Uruguay), adequate adjustments should be made to obtain a more meaningful measure. Similar adjustments should be made in those cases where exports subject to a special exchange treatment are not included in the IFS statistical series and, on the other hand, where exports do not necessarily yield foreign exchange to the country of exportation (e.g., in the case of oil exports, the foreign exchange accruing to the country concerned is in most cases limited to what constitutes local currency needs of the extracting companies).

information, these sets of data offer sufficiently strong evidence to support the views expressed in the following paragraph and the recommendations included in the subsequent chapter, particularly those which aim at improving the collection of information.

Some Quantitative Aspects of Suppliers' Credits

Although no complete statistical series is available, there is evidence that suppliers' credits to developing countries have gradually grown in importance as a form of international finance, since their appearance in appreciable volume early in the 1950's. As shown in Annex V, the increase in the annual net flow of credits of this type between 1960 and 1965 was 60 percent. This has meant that a significant proportion of the outstanding indebtedness of developing countries is made up of this type of debt. As of the end of 1965, obligations for suppliers' credits owed directly or guaranteed by public agencies in the developing countries were close to $6 billion. This was about one-sixth of the total external indebtedness of developing countries which was either public or publicly guaranteed, aggregating somewhat more than $36 billion. The figure of outstanding debt on account of suppliers' credits was probably closer to $7 billion if account is taken of debt not guaranteed by public authorities in the debtor countries.

In 1965 the net addition to the resources of developing countries from these private export credits, of which roughly three-fourths were guaranteed by creditor countries, is estimated to have been about $1 billion. This represented slightly less than 10 percent of total net resources of all types received in that year by developing countries from all origins, which aggregated a little more than $11 billion. Disbursements on official loans in 1965 from DAC countries amounted to $2 billion, and from multilateral agencies to $800 million, both net of amortization. It should be noted, however, that because of the shorter maturity of suppliers' credits in relation to official loans, their gross annual flow to developing countries represents a larger proportion of total gross annual flow than the proportion suggested by the net flows mentioned above. For the same reason these credits account for relatively much more than one-fifth or one-sixth of the current annual burden of service on external debt in developing countries.

It is estimated that about a third, i.e., $1.4 billion, of the estimated total service of $4.3 billion in 1965 on external debt of public authorities in developing countries or guaranteed by them, was due in connection with export credits received from private parties in the creditor countries. The annual service might be closer to $2 billion if account is taken of private debt in developing countries to suppliers, i.e., private debt not guaranteed by public authorities in the debtor countries. The estimated annual service of suppliers' credits in 1965 was equivalent to more than four percent of the value of commodity exports for a sample of some 36 countries, whose total external indebtedness represented about 60 percent of the total of all developing countries.

The large increase in the outstanding debt of developing countries taken as a whole on account of suppliers' credits was unevenly distributed among individual countries. In a sample of 36 countries at the end of 1965, nine accounted for 80 percent of total outstanding indebtedness resulting from guaranteed suppliers' credits. A similar concentration existed with respect to the service payments. 1/ Moreover, in the case of most countries with the highest outstanding indebtedness, the gross inflow of suppliers' credits has not followed a regular pattern during the last 10 to 15 years. This is because of the interplay of various factors reviewed below.

About 90 percent of the flow of guaranteed export credits 2/ to developing countries is estimated to come from Western Europe and Japan, and the balance of some 10 percent largely from the United States. After the initial period of recovery from World War II in the industrialized countries of Europe, short-term private export credits, which had always existed as a traditional form of financing international trade, were gradually pushed into medium-term forms.

Main Factors Affecting the Flow of Suppliers' Credits

As indicated above, medium and longer term suppliers' credits have acquired importance and prominence as a form of international finance only since the Second World War. The causes of this phenomenon will be examined below, and an attempt will be made to identify various special factors which may explain why certain countries have placed excessive reliance on such credits. All are interrelated.

a) The Factors of Over-All Growth

A major reason for the extensive rise of suppliers' credits has been the emergence of independence and positive drive in the national economic policies of developing countries. In earlier decades, major undertakings in low per capita income countries were largely confined to public utilities. In recent years, new fields of investment have been entered, especially in the manufacturing sector, as these countries have inaugurated and pursued industrialization policies. This change has been accompanied by others, such as the pursuit of more nationalistic monetary, financial and exchange policies. In some cases, these have resulted in departures from the traditional rules of financial orthodoxy and, on occasion, the adoption of markedly protectionist

1/ See Tables 2 and 3 in Annex V. These tables do not include Ghana, for which data are not available on a comparable basis. It should be noted, however, that Ghana has made extensive use of suppliers' credits. At the end of 1965, its outstanding indebtedness on account of them was in excess of $400 million, while its total debt outstanding was about $730 million.

2/ Not including credits from Eastern European countries.

trade policies, either deliberately or because of balance of payments problems which led to the imposition of import restrictions. On the creditor side, the absence until late in the 1950's of currency convertibility in industrialized and financially advanced countries, and their limited ability to provide sufficient long-term capital at low interest, have been important factors.

Under these circumstances, the traditional form of financing by long-term bond issues in major capital markets proved to be poorly suited to the requirements of productive activities in the developing countries. The maturities involved were too short and the amount for each undertaking too small for such financing. Inflationary developments and the possibility of exchange difficulties in the potential debtor countries further inhibited the issue of bonds in the exporting countries. Experience shows that developing countries have used private export credits chiefly to finance the acquisition of capital goods (at times only components), largely for the modernization, expansion or construction of new manufacturing plants. It is true that to a smaller though still significant extent, capital goods for infrastructure purposes, such as electric power, transport, and communications, have also been financed in this way, especially in more recent years. Although in these cases the maturities would have been appropriate for the issue of bonds, the other factors mentioned above were important impediments. Moreover, international institutional lending, which to a certain extent filled the vacuum left by the disruption of international capital markets, was confined largely to the financing of infrastructure. Even when it was available, in many cases it could not be obtained because the project to be financed was poorly prepared or of low economic priority. Even the extension of institutional lending at a later stage into the manufacturing sector was too limited in scope and volume to replace private export credits.

At the same time, conditions in the industrial countries favored financing through suppliers' credits. In the first place, two of the most important economic preconditions for selling on credit by individual suppliers prevailed, at least until recently: the existence of adequate excess capacity to produce capital goods, and the availability of domestic finance, either out of the supplying firm's own resources or from the banking system. In the second place, the Governments of these countries, for reasons of their own, acceded to the pressures of their exporters by establishing or encouraging special credit facilities and insurance schemes for exports, which made possible the lengthening of maturities and the broadening of the scope and amount of suppliers' credits.

Although circumstances have favored the emergence and growth of suppliers' credits, this was not an inevitable outcome. Alternatives existed in principle, both in developed and developing countries, and indeed were adopted in a number of cases where conditions were favorable. In developed countries, one traditional alternative was direct investment, and in fact the flow of direct investments has been important. Nevertheless, the emergence of strong nationalist policies in a number of developing countries reduced the attractiveness of this alternative to potential lenders or investors. In developing countries, potential alternatives were: borrowing at home on favorable terms, followed by the purchase of needed capital and other goods against cash payment; or borrowing abroad from private financial institutions, rather than suppliers. The first alternative, however, required domestic financial markets with sufficient capacity to supply the needed funds at competitive interest rates and, at the same time, the predisposition and ability of the monetary authorities to sell the needed foreign exchange. The second alternative required, among other things, that financial policies be pursued by the debtor country which would inspire confidence and induce lending by private foreign financing institutions. These requirements, however, were not frequently met.

b) Factors of Uneven Distribution

As mentioned earlier, at the end of 1965 the outstanding debt owed by borrowers in nine countries on account of suppliers' credits represented about 80 percent of the total for a sample of 36 countries. It may be said that for the majority of those nine countries the level of this type of indebtedness was excessive, since it led to a need for rescheduling maturities; in other cases, it diminished the ability of the countries to obtain further financial assistance. Not only had some countries assumed a heavy burden of debt on suppliers' credits, but there was an excessive concentration on investments which did not contribute to the improvement of their debt servicing capacity.

In nearly all of these countries, suppliers' credits were received by both the private sector and the public sector. A clear distinction between these two users of suppliers' credits is practically impossible, chiefly because manufacturing industries were included in public sector investments financed in a number of the countries. Another reason is that decisions to accept private export credits were made in both sectors by weighing similar alternative forms of financing, based on a comparison of interest costs and maturities; sometimes the deciding factor in both sectors was sheer availability of resources. Generally speaking, however, two distinctive additional alternatives are available to the public sector borrower, at least in principle: the possibility of raising public savings through additional taxation or reduction of current expenditures; and more direct access than the private sector to the sources of international public lending. Moreover, the central authorities should, in principle, be in a position to exercise control over the volume and terms of suppliers' credits obtained by public or semi-public agencies, in addition to the control exercised through the granting of guarantees. Finally, the undertaking and financing of infrastructure investments is, as a rule, an almost exclusive prerogative of the public sector.

The reasons for the excessive indebtedness were not the same in each country. Some of the countries were characterized by strong, protracted inflationary developments; these induced exchange policies which led to balance of payments deficits; in attempting to redress the balance of payments, quantitative restrictions were imposed on a large number of imported goods, usually those labelled non-essential. Behind the shelter provided by these restrictions, or possibly by high tariffs (or other equivalent tools, such as import or exchange surcharges), industries producing goods which could not be imported became highly profitable in terms of local currency, particularly where the cost of imported inputs was kept low through preferential exchange rates. These industries became a fertile ground for suppliers' credits, especially when the expectation that the monopolistic or near-monopolistic position they enjoyed in the domestic market led both parties to believe that comfortable profits and the capacity of the firm to service the credit would continue for the foreseeable future. There may have been cases in which the decision to set up a producing unit with the help of a suppliers' credit was concomitant with the authorities' decision to prohibit or severely restrict the importation of the goods concerned.

The strong private incentive to undertake and finance this type of investment did not encounter much restraint, either by governments of the receiving countries or by those of the suppliers' countries. On the contrary, most of the former were quite favorable to, or even encouraged, their residents to undertake suppliers' credits without subjecting them to careful scrutiny before granting authorizations or guarantees. These credits were extended, as a result, with little regard to the economic soundness of the projects - as distinct from their profitability in local currency -, or the suitability of the terms and their effects on total indebtedness, including that resulting from this type of credit as well as from foreign loans in general. From a historical point of view, it should be observed that the inclination of certain debtor countries to authorize ready recourse to suppliers' credits was heavily influenced by the fact that other sources of international finance were practically inaccessible to them. This was basically a consequence of their inflationary financial policies, which made it impossible for them to borrow in large amounts from international financial institutions, and even from individual foreign governments or private financial institutions. Thus, whenever in these countries top priority was attached to investments regarded as important to the pursuit of development, for which recourse to foreign resources was necessary, suppliers' credits proved to be one of the few sources of foreign financing, if not the only one. In certain cases, the unavailability of public international financing was due to the fact that enterprises, especially in the public sector, were not prepared to subject themselves to the scrutiny usually insisted upon by international lending agencies.

The pattern just traced has not developed in all countries where suppliers' credits have been excessively used, since in some of them inflationary trends have been virtually nonexistent or rather limited. The overuse of suppliers' credits in other cases resulted from various causes. Some individual credits were not guaranteed at either end of the transactions, and in some cases no exchange control system was in effect. Thus, there was no way to control the assumption of this type of debt by enterprises in the private sector, so that profitability for the individual buyer and supplier was the determining factor. It is more difficult, however, to justify the failure of some countries to exercise effective control in the public sector. In recent years especially, the public sector in some countries has undertaken more of this type of debt than the private sector; in some cases, suppliers' credits for a few projects of public or semi-public enterprises have contributed heavily to mounting foreign indebtedness. In a few cases, the failure of public authorities to intervene probably resulted from political considerations, or from a failure to foresee the need for a clear and balanced foreign debt policy and procedures to enforce it. Certainly in some countries, controls by the central administration over the assumption of debt by autonomous public institutions was too loose to be effective. On some occasions, it appears that the responsible agencies of government simply were not consulted or well informed about the financing plans of such public or semi-public enterprises. Sometimes, projects financed by suppliers' credits were not subjected to adequate technical and economic study to determine their priority or explore the possibility of financing by international institutions. Some semi-public or decentralized public agencies incurred heavy foreign debt to carry out overly ambitious investment programs. In such cases, the responsible officials often had limited experience in estimating the cost or judging the merits of the proposed projects, and perhaps were unaware of the need for expert and objective assistance.

Some developing countries offer a striking contrast. They have kept their domestic and foreign financial policies under reasonable control, and have thus avoided crises and maintained their credit intact. They have been more willing to subject project proposals to critical scrutiny, and have thus obtained more development advantage from their scarce resources. In consequence, they have enlarged their possibilities for obtaining external finance from public sources and reduced their need for reliance on suppliers' credits. For example, this has happened in the wide variety of countries to which the World Bank Group has given substantial assistance through development finance companies. 1/ The international consortia and consultative group arrangements may also have tended to limit recourse to private external credits, through the special efforts involved in obtaining an adequate flow of public international finance.

Part of the explanation for the excessive use of suppliers' credits by certain debtor countries is found in the creditor countries. The policies of creditor countries have been an important contributing factor, since most of the credits were guaranteed or otherwise facilitated by government action. By using selective criteria in applying

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1/ As of June 30, 1966, the World Bank Group had committed $492 million of loans and investments to development finance companies in 21 countries.

their facilities, they could have discouraged the unwise transactions. In administering their guarantee systems, however, some creditor countries did not apply the creditworthiness and project evaluation standards which were being adopted by international lending institutions. One problem may have been a lack of information about the effects of suppliers' credits on the total indebtedness and economic performance of the debtor countries. Thus, creditor countries may not have been sufficiently aware of the consequences of such credits extended by their own residents. If there was such awareness, these consequences probably weighed less heavily in some cases than the commercial and balance of payments policy objectives of the creditor countries. In addition, creditor countries at times appear to have facilitated the extension of suppliers' credits in response to domestic economic, social and political pressures from depressed sectors.

The limited number of countries reviewed above and the information available about them has facilitated the task of identifying some of the major factors that led to excessive use of suppliers' credits. Far more difficult would be an attempt to explain why the other countries, which constitute the large majority, were relatively immune. It would probably be too much to say that it was always the result of deliberate policies. There is no evidence that better information was available which might have resulted in effective restraints. It may have been that the strong profit incentives which attracted large amounts of suppliers' credit to a few countries were lacking in the others. Nevertheless, it may be assumed that the policies of debtor and creditor countries played an important role where suppliers' credits were kept within appropriate bounds.

Problems in the Use of Suppliers' Credits - Cost to Users

While bearing in mind that private export credits have an appropriate role to play in international finance for developing countries, the following paragraphs focus on problems which have arisen as their volume has expanded in recent years. One is the cost of this form of finance. Another is the accumulation of repayment obligations which burdens the debt servicing capacity of some countries.

Private export credits are a relatively high-cost form of finance. The link with government insurance or refinancing may induce a flow of such credits that might otherwise not be available at all, but such concessionary elements do not always reduce their cost to the user. Furthermore, even when credits are insured to the extent of 80-90 percent of their value, some risk is still assumed by the exporter, which he may attempt to overcome by overpricing the goods. This element is equivalent to an additional interest rate.

Explicit annual interest charges on suppliers' credits in recent years have frequently been in the neighbourhood of six percent. It is difficult to determine when and to what extent the prices charged for the goods, and consequently the principal amounts of the credits, have also included an element which in effect was an addition to interest. Moreover, the actual rates depend on whether the nominal rates are related to the original amounts or to outstanding balances. Sometimes the former was reported to be the case. A recent World Bank mission to one member country found that the average weighted interest rate on substantial suppliers' credits to that country ran, on this account alone, to about 11 percent per year.

The possible hidden costs of financing imports may be reduced by separating the two functions of exporting and financing. If this is done, the buyer is free to shop around for the goods which are most suited to his needs, taking into account such factors as quality, price, servicing, and delivery schedules. Financing is obtained independently. This, however, dispenses with the convenience of suppliers' credits, an inherent feature of which is that the seller provides the financing. This feature tends to be costly. One effective way to reduce its cost is through competition among suppliers in different countries. For example, Yugoslavia and India appear to have been partly successful in mitigating some of the effects of the tied nature of suppliers' credits by prescribing that borrowing enterprises must present at least three suppliers' credit offers from three different countries before they can obtain guarantees, which are compulsory.

In certain cases suppliers' credits have been vehicles for costly operations in terms of the distortion of investment priorities. This has resulted from the lack of adequate supervision by the authorities of the receiving country over the economic soundness of the project, its technical quality, the adequacy of credit terms, etc. This occurred in one member country with respect to projects in the fields of water supply and transport. In the same country, there was excessive emphasis on consumer goods industries rather than industries to produce intermediate or capital goods, as called for by the existing development plan. In another country, a number of publicly-owned industrial ventures of doubtful economic justification or financial viability were facilitated in such fields as textiles, steel, hardware, and motor vehicle assembly. In still other cases, undertakings of dubious merit were encouraged by virtue of the fact that feasibility studies for them, carried out by the suppliers themselves, may not have been thorough or complete.

In circumstances where investment decisions, facilitated by suppliers' credits, are not subject to adequate supervision, the guarantees granted by the government of the recipient country may encourage the lender to be lax in establishing the borrower's credit. Especially in the case of a publicly-owned enterprise, repayment of the credit may not require the financial success of the enterprise itself, since it is made out of the governments budget. In some countries, the governments have been repaying suppliers' credits for public enterprises which cannot meet their obligations because they have not reached the stage of profitable operation. In some cases contracts have been signed for machinery and equipment without provision for plant construction and engineering. The lag between such equipment contracts and actual operations has been as long as five years for some projects. Not only were the maturities of these suppliers' credits inappropriate to the life of the equipment or to the pay-out period of the project, but the credits also involved payment before the equipment could even be installed.

The Service Burden and the Flow of Finance

Perhaps even more than the costs mentioned above of private export credits to the users, it is the burden of servicing such credits which has brought this form of international finance to the attention of the international community in recent years as a cause of major, widespread concern. Earlier in this chapter an attempt was made to explain the reasons for the concentration of suppliers' credits in relatively few countries. In some of these countries the accumulation of repayments obligations on account of these credits has coincided with and added to similar obligations of the public sector resulting from loans or other forms of indebtedness. This has led to debt servicing crises in recent years in the case of a number of countries, such as Argentina, Brazil, Chile, Ghana, Liberia, and Turkey. In addition, the case of Indonesia is currently being examined.

a) Problems Facing the Debtors

The over-all accumulation of external debt by developing countries has proceeded at a rapid rate in recent years, 1/ and the contribution of suppliers' credits to this debt in some countries has been appreciable. As indicated in Annex V, for a sample of 36 countries representing some 60 percent of the total outstanding external debt of all developing countries as of the end of 1965, the ratio of external debt service payments to the value of exports in 1965 was 13.4 percent, including a ratio of more than four percent between service payments on suppliers' credits and the value of exports. Of these 36 countries, half had a service ratio on total external debt of 10 percent or more and, among them, eight 2/ had service ratios on account of suppliers' credits alone ranging from 4.7 to 20 percent.

When the total debt service burden reaches such a high level as to cause a balance of payments crisis, all alternatives to rescheduling service payments are painful and undesirable. In principle, the easiest course would be to attract foreign funds or induce the repatriation of domestic funds to alleviate the payments situation, at least in the short run. This is very difficult to achieve, however, in a situation of impending crisis. Another alternative would be the drastic reduction of imports and other payments, but this normally would

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1/ See "Trends and Outlook in Development Finance," in the World Bank/IDA Annual Report for Fiscal Year 1965-66.

2/ These eight countries are Argentina, Brazil, Chile, Mexico, Peru, Turkey, U.A.R., and Yugoslavia. Comparable figures for Ghana are not available.

have serious internal repercussions on the level of economic activity. If the reduction were achieved through devaluation, the magnitude of the internal repercussions would normally be very large, and would produce unsettling effects on the domestic price structure as well. Still another alternative would be a default on payments, but this would seriously weaken the confidence in the country at home and abroad and impair its credit for a considerable time.

For these reasons, the countries mentioned above have considered international action to reschedule service payments to be the least of several evils. 1/ The debt rescheduling operations undertaken in recent years have normally required a rescheduling of payments due on account of suppliers' credits, and often they have been confined to this type of credits alone. This has been in part because of the heavy share they represent in the total debt service of the debtor countries, but it has also reflected the judgment of both the creditors and the debtors that the rescheduling of other types of loans was not appropriate.

In the debt rescheduling operations, a main concern of the creditors has been to avoid recurrence of over-indebtedness. In the early rescheduling operations, creditor countries appear to have been satisfied with general policy assurances or commitments laid down in stand-by arrangements with the International Monetary Fund. More recent rescheduling agreements, however, have included limitations for certain periods of time on the amount of credits to be contracted with a maturity of less than a certain minimum number of years. Thus, the large volume of suppliers' credits contracted in the period preceding payments crises may be followed by periods of limitations on the volume of such finance with maturities not exceeding agreed limits. As a consequence, applications for new suppliers' credit permits within the proscribed maturities might pile up if there is an expectation of a more liberal release in the future. The flow of suppliers' credits may thus undergo more or less wide swings, which can only be detrimental to the interests of exporting and importing countries alike.

b) Some Cases of Rescheduling Operations

The flow of suppliers' credits has been affected recently by rescheduling operations for Argentina, Brazil, Chile and Liberia, as a result of the limiting clauses in the respective agreements with creditor countries. 2/ In the case of Liberia, this was an indirect result

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1/ It is to be noted that in some countries debt rescheduling operations did not result from excessive indebtedness on suppliers' credits.

2/ In December 1966, an agreement was reached, ad referendum, on the rescheduling of Ghana's debts on suppliers' credits.

of clauses in that country's stand-by arrangement with the International Monetary Fund. In some instances, one of the effects of these clauses was to induce both creditors and debtors to lengthen the maturities of new suppliers' credits. Moreover, rescheduling arrangements covering the payments falling due during a single year sometimes proved to be insufficient to solve the debt burden problem created by suppliers' credits received in the past. This resulted either from the fact that heavy repayments in one year repeated themselves in following years, or even from provisions which added heavily to the debt burden of subsequent years by requiring that the postponed commitments be repaid over a relatively short period of time. In some cases the possibility that successive rescheduling operations might be needed in future was openly acknowledged at the time of the agreements.

Cases of successive rescheduling operations are offered by Argentina, Brazil and Turkey, and in each of them the factors mentioned above played an important role. Argentina's reschedulings took place in 1957, 1961, 1962 and 1965. Specific limitations on suppliers' credits up to eight years were agreed upon in 1965. They involved commitments that credits received by the private sector with maturities up to five years and those received by the public sector with maturities up to eight years would not be authorized in excess of amortizations, net of the refinancing. It was also agreed that private sector suppliers' credits with maturities between five and eight years could be authorized to the extent of the full amortizations. In addition, the creditor countries received further assurances from the Argentine Government about the conduct of its financial policies. In particular, they received two additional specific commitments covering the exchange rate policy and the elimination of commercial arrears. These three commitments complemented each other, in that they all aimed at assuring a satisfactory foreign financial policy during the period 1965-1966.

In Brazil reschedulings took place in 1961 and 1964. At the time of the first agreement, the country maintained a stand-by arrangement with the IMF. In 1964, however, in the absence of such an arrangement, creditor countries received from Brazil specific commitments, applicable to that year and 1965, providing that suppliers' credits of up to eight years should not be authorized in excess of amortizations net of refinancing. It was anticipated by Brazil that it might need a similar operation in 1966, but favorable developments in the 1965 balance of payments obviated further reschedulings.

Turkey had resorted heavily to suppliers' credits in the period leading up to the crisis of 1958. In that year, a stabilization program was adopted after consultations with the OEEC and the IMF, and a rescheduling of obligations due on commercial transactions was worked out under OEEC auspices in 1959. About two-thirds of the total external debt outstanding at the time of the crisis in 1958 was due to private foreign suppliers. Since the 1958-59 stabilization and rescheduling arrangements, and with the establishment of a consortium for Turkey under OECD auspices in 1962, the country has strictly limited its recourse to suppliers' credits. However, the falling due of the payments which had been rescheduled earlier required another such operation in 1965, under the auspices of the OECD consortium. Turkey's service ratio on total external debt was still close to 20 percent in 1965, including some five percentage points on account of suppliers' credits, 1/ but this represented a decline from a total debt service ratio of over a third in the early 1960's.

The repetition in recent years of rescheduling operations appears to have had some effect on the attitudes of creditor countries with respect to their overall credit policy toward developing countries. They appear to recognize their interest in avoiding the granting of excessive credits, since excesses by some creditors increase the risk of default for all. There is also broader recognition of the causal relationship between excessive debt burdens and the financial policies of the debtor countries; the type of investments that these credits helped finance did not adequately contribute to the expansion of export receipts or, in general, to the improvement of the debt servicing capacity of those countries. This is true even though some investments financed by suppliers' credits have resulted in a saving of foreign exchange.

c) Inadequacy of Existing Arrangements

Some of the problems with private export credits are intensified by deficiencies in existing arrangements for their use and supervision. The decentralization of large numbers of credit operations, which results from the fact that credits are extended by suppliers rather than financial institutions, aggravates the tendency towards excesses and inordinate competition. Inadequacies in the collection and reporting of information about the use of such credits hinders the timely adoption of policies to forestall difficulties or cope with them when they arise.

Existing systems of data collection among both creditors and debtors make it impossible to present a complete picture of the international flow of this form of finance. 2/ The largest uncertainty is in the area of purely private credits, with no involvement of public authorities through the provision of guarantees or otherwise. Even where guarantees are granted and information is readily available on the guarantees themselves, there is frequently no follow-up to indicate their actual utilization. Frequently, therefore, data on the flow of such credits may permit only an approximation, based on authorizations as reflected in guarantees granted. Furthermore, details on transactions reported to have been financed are frequently inadequate for

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1/ See Table 3, Annex V.

2/ See Annex V.

purposes of economic analysis and policy making. Even if adequate details were available to the countries themselves, however, it would be difficult to contend with their reluctance to reveal such information about the activity of their private sectors. And in many cases, even with the best of will, there are difficulties of administration which make for incomplete or tardy reporting.

As previously noted, the commonest form of governmental participation in suppliers' credits is the provision of insurance. Such participation, however, offers no assurance that the transaction is sound from the importing country's point of view, nor does it assure the financial viability of the borrower or the debtor country. The assumption of risk by governments is designed primarily to promote exports in the face of foreign competition. Moreover, any government would consider that a restraint on its part would not benefit the importing country, since it only would leave a void which another exporting country would fill. As indicated earlier, efforts at the international level to coordinate the flow and terms of private export credits to developing countries on an over-all basis have so far produced little effective and enduring results.

IV. CONCLUSIONS AND RECOMMENDATIONS

Experience with suppliers' credits during the post World War II period leads to the following conclusions:

A. Suppliers' credits have played a large and useful role in the flow of international finance to the developing countries. There is a powerful impetus to their utilization by both creditor and debtor countries. On the creditor side, they are a means of moving exports in competition with other supplying countries; on the debtor side, they are a means of financing investments for which, under the circumstances, the alternatives are too costly or, for all practical purposes, not available. Such credits will continue to play a significant role as a form of international finance appropriate to certain types of transactions and useful in others.

B. Experience also shows that excesses have appeared in some cases in the use of suppliers' credits, parallel to their growing importance: instances of excessive indebtedness; maturities not commensurate with the life span of the investment; certain high hidden costs of financing; and distortions in the importers' judgment of the priority and productivity of the investments. These excesses have manifested themselves in more pronounced forms in certain countries than in others, leading to payments crises and rescheduling arrangements. These arrangements, in turn, have induced swings in the capital flow to the developing countries concerned. The causes of these excesses and shortcomings have been varied: unsound financial policies in receiving countries; relative unavailability of other forms of international finance; excessive use of protective devices; inadequate controls on the borrowing firms or public agencies; insufficient competition among suppliers; inadequate attention on the part of the creditor (guarantor) countries to the soundness of the financed projects, to the existing debt burden of the receiving countries, and to the possible adverse effect of additional credits on the servicing of those previously granted by their exporters. Inadequate information on indebtedness on account of suppliers' credits and on total indebtedness of receiving countries has been an important contributing factor to such excesses. Until now information on these matters has usually been collected as a result of the implementation of guarantee arrangements, in most cases with the limited purpose of recording commitments. It does not cover a number of quantitative aspects of the credits and is inadequate in terms of details, particularly those relating the credits to the economic and technical characteristics of the projects financed. Finally, in most cases the data collected on the debtor side cannot be reconciled with those collected by the creditors.

These conclusions point to four principal aspects of suppliers' credits on which attention should be focused, with a view to evolving policies and actions that would correct the excesses and strengthen the effectiveness of this type of financing in the general framework of the international flow of capital to developing countries. These relate to collection of information, foreign debt administration, coordination of creditors' practices, and international coordination for individual debtor countries. Improvement in the flow of information and better coordination might, in turn, provide elements for analysis in depth of the use of supplier credits by some typical countries, and for consideration of possible financing arrangements to deal with the credit role separately from the supplier's function in the underlying transaction. These considerations give rise to the following recommendations:

1) Collection of Information

A necessary first step is improvement in the collection of information on the flow of international finance and on external indebtedness, as a basis for appropriate policy measures. This applies at both the national and international levels. In order to achieve improvements at the international level, the starting point should be the collection of information by individual countries, both creditors and debtors. With respect to information that comes within the purview of existing international systems of reporting, efforts should be made to obtain such reporting in as complete a form as possible. Should technical assistance be required by individual countries, it could be provided by the international agencies which presently operate such collection systems, the World Bank with respect to debtor countries and the OECD for creditors, as well as by the IMF in the context of its balance of payments reporting. The Bank and the OECD have agreed on steps to improve the reporting system for creditor countries, which may make it a more useful complement to the system of information collection from debtor countries.

Since one of the main purposes of collecting such information is to have a clear picture of the indebtedness of the debtor countries and of its term structure, information from these countries should be far more meaningful and useful. A proper assessment of the debt burden on account of suppliers' credits can be obtained only if indebtedness on these credits is viewed within the framework of the total indebtedness of both the public and private sector. It has been a constant preoccupation of the Bank over the years to examine in detail and assess the foreign debt situation of member countries in connection with its lending operations. The Bank's economic reports on member countries regularly contain specific chapters on these matters. Where appropriate, it is the intention of the Bank to improve further the coverage of its information, so as to obtain a complete picture of the total debt and its term structure.

It should be possible to make considerable progress in obtaining information on suppliers' credits. The biggest gap exists in the area of completely private initiative, where no government guarantees are involved at either end of the transactions. Considerable improvement should be obtained in this area on the basis of authorization procedures where they exist as part of exchange control systems to check capital movements. Since authorized credits can be utilized in several installments, with varying delays, or not be utilized at all, appropriate arrangements should be made to obtain data on actual utilization. Where the exchange system does not permit the introduction of an authorization procedure, information might be gathered through voluntary reporting by the private sector; alternatively, it might be obtained through other techniques which are used for the compilation of the balance of international payments under procedures established with the guidance of the IMF. Furthermore, there is need for expansion of the data which are now reported to the Fund, so as to harmonize the information relating to private capital movements with that obtained under the reporting systems managed by the OECD and the Bank. The three agencies are in close contact with each other on these matters.

The information collected on private export credits should be sufficiently comprehensive to yield all the details necessary to the most meaningful economic analysis in this field. Compatible with the need for respecting confidential business relations, attempts should be made on the creditor side to develop better and more direct data on the actual flows of suppliers' credits. On both the creditor and debtor sides, more information should be collected on the types of goods and economic activities which are financed by such credits, so that a greater appreciation can be gained of their appropriateness to the purposes they serve.

2) Administration of External Debt

There is great need for improvement in the administration of external debt by individual developing countries. This should be considered along with the various other elements that are examined in judging development performance by such countries. Sound economic and financial policies are important to the prevention of excesses in the use of suppliers' credits, since they help to create an economic environment in which the risk of distortions through the assumption of such debt is minimized. In the course of their regular work, the Bank and Fund have the opportunity to review with the national authorities of member countries their domestic and foreign economic policies. One of the main objectives is to see to it that such policies are conducive to private and public sector decisions on the utilization of available foreign resources which are in line with sound economic objectives. The pursuit of such policies has a favorable bearing on the readiness of international or national financial institutions abroad, private or public, to finance projects which fall within the scope of their operations, at terms more favorable than suppliers' credits.

In addition, developing countries should organize systems to provide themselves with continuous knowledge about the contracting of suppliers' credits. They should be in a position to exercise adequate control or guidance over such transactions. This should be an important element in the management of their total balance of international payments and should be exercised in harmony with national investment and monetary goals and policies established for the economy.

Particular restraint should be exercised in processing proposals for suppliers' credits destined to finance activities which are made profitable by the maintenance of import restrictions imposed for balance of payments reasons. Developing countries could take advantage of the experience and information available to international organizations, by seeking technical assistance, where possible, before authorizing investments to be financed by suppliers' credits under these conditions.

Successful management of indebtedness problems should weigh importantly in decisions concerning the availability of external sources of development finance, since it would be important evidence of the desire and ability of the developing country to manage its affairs satisfactorily. The contracting of additional foreign obligations should be decided upon against the background of existing foreign debt, both in terms of its total amount and of the repayment schedule, and in relation to the prospective debt servicing capacity of the country. This could best be done by centralizing decisions on foreign indebtedness, particularly direct obligations of the public sector, including suppliers' credits contracted by public sector agencies. Both the use of prior authorization procedures and the effective enforcement of budgetary controls are appropriate for this purpose.

In regard to the private sector, practical ways should be explored for pooling requests for private external credit through local development finance companies or otherwise, so as to improve the terms and conditions of the credits. External credits contracted in large blocks are much more likely to have favorable conditions than numerous, fragmented credits for many small enterprises. In some cases, local branches of private foreign banks may be useful for this purpose.

Finally, the maturities of suppliers' credits should be related more closely to the useful life of the goods they finance. Sound financial practice requires that such relationships be observed. The longer maturities, which in any case are relatively scarce, should normally be reserved for equipment with a long life and for projects with long pay-out periods; by the same token, maturities well below the life of equipment financed might constitute an undesirable burden on an enterprise.

3) Coordination of Creditor Practices and Policies

So far, the governments of creditor countries have refrained from taking the lead with respect to policies and practices concerning the use of suppliers' credits, preferring to rely on the judgment of borrowers to avoid inordinate debt and assure the most effective use of available funds. For the most part, their active intervention has been limited to providing support to their own exporters through guarantees and credit insurance, on the one hand, and participation when necessary in such remedial measures as rescheduling operations, on the other. If the considerable advantages of suppliers' credits are to be retained, however, it seems essential that steps be taken without long delay to avoid the further spread of excesses which can only lead to harmful results for all concerned. Most urgently, action is needed along two principal lines: (a) The harmonization of commercial and financial practices with respect to the technical aspects of the transactions involved; and (b) The formulation of more purposeful policies designed to anticipate and forestall some of the more disturbing tendencies inherent in this form of finance.

As related earlier, efforts so far made to harmonize commercial and financial practices have yielded limited results. Though the creditor countries' organizations concerned with export credit and export credit insurance are numerous, none seems to be adequate for the type of cooperation required. What seems to be necessary is some new kind of quasi-permanent cooperation among the creditor countries. It is for the creditors themselves to decide on the details of a mechanism for achieving such cooperation. The representation of both the Ministries of Finance and of export credit companies probably would be desirable. The arrangements should be flexible and adaptable to changing sets of problems. The approach of the EEC possibly offers the best example of the necessary adaptability. It established a procedure under which its "Coordinating Group for Policies of Credit Insurance, Guarantees and Financial Credits" would hold regular monthly meetings and maintain a permanent Secretariat. Between sessions of the Group, the Secretariat and members were to remain in contact and be prepared to consider questions expeditiously; for instance, they could consult quickly when a member had to report a contemplated credit of exceptional terms, or required the approval of members on other matters. An obvious obstacle to the extension of these arrangements to a group including all creditor countries would be the large number of members. Perhaps a workable approach would be to form a small permanent secretariat, organized by creditors or international institutions, which could utilize the expertise of existing organizations to serve ad hoc groups of creditors. The composition of these groups would vary with each debtor country, in order to limit the participation in coordinating activities to the small number of principal creditors concerned. This flexible approach would allow the inclusion of countries which are not members of any of the three groups mentioned.

With regard to the second area of cooperation referred to above - the harmonization of policies -, it should be stressed that neither the problems associated with private export credits nor those of public international capital flows can be effectively attacked if they are considered in isolation from each other. An appropriate forum for the formulation of general policies and principles to guide creditor countries would seem to be the OECD, which is concerned not merely with the economic problems of its own industrialized members, but also with the impact of their economic activity on the developing countries through trade and the international flow of capital. In some cases, however, a broader basis may prove to be necessary to include countries which are not members of the OECD.

The emphasis in consideration of suppliers' credits by the OECD or other groups should be on the adoption of broad, common principles to guide the actions of creditor countries in avoiding problems of the type which have arisen in individual debtor countries, as distinguished from actions taken to deal with current problems. Agreement might be sought with respect to the following types of objectives: Recognition by creditor countries of a responsibility to restrain their own financial and commercial institutions when considered necessary to avoid excessive assumption of credits by a debtor country; the desirability of promoting facilities which make possible more alternatives to the importing countries in the procurement of goods financed by suppliers' credits; the desirability of distinguishing between exports not related to development as contrasted with exports made possible as a matter of public policy to assist development in other countries.

Agreement on a set of principles, however, need not be a precondition for concrete steps to deal with problems raised by the excessive use of suppliers' credits. The very process of exchanging views on such common principles should help create a consensus of policies and practices on this subject which would help in dealing with problems as they arise in the future. It may well prove that uniformity of credit practices and restraints may not be feasible or practicable at the present time. The feasibility or desirability of such common practices should be subject to continual re-examination by the OECD or other groups after more experience has been gained on the various fronts of international cooperation in this field.

In specific cases, the policy deliberations would have as a basis the systems of data collection operated by both creditors and debtors with the help of international agencies, which should be improved along the lines recommended in earlier paragraphs. In addition, as already mentioned, creditor countries may find helpful the assessment of the foreign debt situations of debtor countries which the World Bank makes periodically in its economic reports on member countries.

Creditor countries could also review the relative roles of suppliers and financial institutions as channels for the granting of private export credits. Consideration should be given to possible policy measures that might enhance the role of private financial institutions, rather than suppliers, in such financing.

4) International Coordination for Individual Debtor Countries

Although the interest of individual debtor countries is the object of suggestions made in the preceding paragraph, there is also scope for more specific arrangements to deal with various aspects of the indebtedness of these countries.

One problem, often mentioned in connection with the high cost of suppliers' credits, stems from the fact that in some cases competition among suppliers is either limited or nonexistent. This may result from the fact that residents of many countries have limited opportunities to establish or maintain contacts with industrial centers in developed countries. As a remedy, consideration could be given to the possibility of having existing international organizations with experience in these matters act as channels of information, disclosing to their member countries the interest expressed by a developing country in receiving suppliers' credits for a particular investment.

Other coordinating activities for individual debtor countries can be carried out through related groups of creditors. In the case of some debtor countries, there are already consortia or consultative groups concerned with the total flow of international finance in relation to the overall development situation and prospects of the individual countries involved, including their indebtedness problems. The analysis necessary for periodic assessment of these questions involves a comprehensive view of the country's economic performance, of the same type which is at present provided by the staffs of the agencies which manage such groups: i.e., the World Bank, the OECD, or the Inter-American Development Bank, depending on the country, with the assistance of the International Monetary Fund. Where such groups exist, creditor countries may decide to consider the problems associated with suppliers' credits at their periodic meetings, as a part of their assessment of the debt situation and prospects of the debtor country concerned.

Where these groups do not exist, or if their members should feel that they do not represent an appropriate forum, consideration could be given to the formation of ad hoc groups which would examine the suppliers' credits situation of individual debtor countries. Developed countries have the opportunity of analyzing the domestic and external economic situation of individual developing countries through the reports issued periodically by the Bank and the IMF, among others, as a part of their respective operations. On the basis of the assessment contained in these reports, those developed countries which have a particular interest in any individual developing country might find it appropriate to consult with each other specifically on this subject, by meeting or otherwise. If they should then conclude that measures were needed to correct trends in the debt situation of the debtor country concerned, they might find it appropriate, for example, to suggest to the country that it consult with the Bank, the IMF, or both to arrive at a formulation of ways and means to prevent the foreign debt situation from getting out of hand. For example, these might include ceilings of the type adopted in rescheduling operations, accompanied by adequate supporting policies.

In the case of a few countries, groups of creditors already exist under the informal name of "Clubs," such as the "Paris Club" or the "Hague Club," which in recent years have been utilized to negotiate the rescheduling of external debts. These clubs could also be used for the international management of suppliers' credits, with the objective of eliminating or avoiding the need for rescheduling exercises.

5) Subjects for Future Consideration

The preceding recommendations are based on available information concerning suppliers' credits and are aimed at improving the national and international management of this type of credit. Their implementation depends basically on the preparedness of the countries concerned to take the necessary decisions. Two further aspects of the problem could be subjects for future consideration. One concerns the gathering of more detailed information on the subject; the other, alternatives to suppliers' credits.

Most of the available statistical data and other information concerning individual countries has been obtained for the operational purposes of international institutions. For this reason, it is confined to certain essential aspects of foreign indebtedness. Although such information has been found adequate as a basis for broad conclusions for the purpose of this report, it should be supplemented by analysis in depth of the use of suppliers' credits by the countries concerned. A useful contribution in the field could be made by intensive case studies of selected debtor countries which have made substantial use of such credits. Some of these have met with considerable difficulty, others have been able to overcome the major problems, and still others have managed the use of suppliers' credits with relative success.

With regard to the second aspect of the problem mentioned above, it may be noted that the World Bank, in some of its own operations, has introduced the principle of international competitive bidding in the use of national export credits. In such operations, suppliers' and financial credits are combined with Bank funds for the financing of a particular project. Tenders for the supply of equipment, exclusive of the credit terms, are invited under a procedure of international competitive bidding. Once the contracts are awarded on this basis, national export credit facilities are used to the fullest extent possible, supplemented by Bank financing. There could be a similar international approach on the private banking level, in areas of financing where the importer does not otherwise have sufficient choice among countries in making his purchases.

ANNEX I

Text of Annex A.IV.14 of the Final Act of the U.N. Conference on Trade and Development (Geneva, 1964)

SUPPLIERS' CREDITS AND CREDIT INSURANCE IN DEVELOPED AND DEVELOPING COUNTRIES

THE CONFERENCE,

HAVING IN MIND the number and importance of the questions relating to credit and credit insurance which have been raised by both the developing and developed countries and the variety of proposals put forward for action in this field,

RECOMMENDS that the International Bank for Reconstruction and Development should be invited:

1. To make a study of the use (actual and potential) and terms of suppliers' credits and credit insurance, including rediscounting arrangements:

(a) For financing exports from developed to developing countries, taking account of the capacity of the latter to repay and of other effects on their economies and balance of payments;

(b) As regards their effects on competition between the exports of developing and developed countries, as well as between the developed countries;

(c) As a means of financing trade between the developing countries;

2. To take account, in so doing, of the relevant observations, recommendations and suggestions submitted to the Conference, including those in the draft recommendation by Spain and Tunisia annexed hereto;

3. To identify the difficulties which arise or may arise, in particular as regards debt service, and to consider possible solutions;

4. To submit the study to the United Nations at the earliest possible date together with any appropriate recommendations.

APPENDIX

I

TEXT OF THE DRAFT RECOMMENDATION PROPOSED BY SPAIN AND TUNISIA

With a view to adapting supplier credits to the circumstances and requirements of the developing countries, THE CONFERENCE RECOMMENDS THAT:

1. The International Bank for Reconstruction and Development should study the establishment of a multilateral inter-governmental credit insurance institution, taking into account the practice and experience of the national credit insurance systems operating in certain developed countries;

2. The object of the institution should be to cover risks incurred in respect of supplier credits by guaranteeing insurance and re-insurance for the supplier granting credit;

3. The institution should also, insofar as possible, be prepared to extend its financial assistance beyond the coverage of the risks referred to in paragraph 2 above, with a view to reducing the costs incurred by the developing countries for the use of supplier credits;

4. The developed countries should furnish the developing countries with the most extensive technical assistance possible in regard to exports, in order to help those countries:

(a) To establish, promote and expand, at the national or regional level, credit insurance organizations to promote external trade through guarantees designed to reduce risks, especially the credit risks which such trade involves;

(b) To set up or improve their machinery for financing exports (external trade banks, rediscounting institutions, etc.).

II

CONSIDERING that one of the most effective forms of assistance is the promotion of exports, especially of manufactures and semi-manufactures, from developing countries,

CONSIDERING that in order to export such goods, those countries not only have to meet competitive qualities and prices, but also have to offer terms of sale (deferred payment, credit to purchasers, etc.) similar to those offered by industrialized countries - which is often beyond their means,

THE CONFERENCE RECOMMENDS:

5. That existing international finance organizations undertake the study of the measures to be taken to enable developing countries to gain access to world markets on credit terms comparable to those of industrialized countries:

6. That, to that end, the possibility should be studied of enabling commercial drafts relating to export operations of developing countries, duly endorsed by the central bank or by any body offering adequate safeguards, to be rediscounted at a reasonable interest rate.

ANNEX II

General Evolution of Export Credit and Export Credit Insurance Systems 1/

In the post-war period, the industrialized countries' desire to promote their exports of capital goods, combined with the inadequacy of the developing countries' capacity to import such goods for their expanding development needs, have resulted in changes in the methods by which international trade in such goods is financed.

External financing for the purchase of capital goods needed in developing areas had formerly been obtained through long-term borrowing on the world capital markets or through direct investment by foreign enterprises. Even before 1939, however, the capital markets had become largely closed to the developing countries. Direct foreign private investment underwent a period of growth during the 1950's, but has levelled off since the beginning of the present decade and seems unable to meet the developing countries' requirements. Additional long-range financing, some of it on grant or concessional terms, has been made available through bilateral and multilateral programs, but has not been able to keep pace with the enormous expansion of the financing demand for capital goods.

In their search for alternative sources of funds, the developing countries have come to depend increasingly on the suppliers of goods for the necessary financing. In the sellers' market which characterized the immediate post-war period, and prior to the spreading of direct suppliers' credits, a number of capital-goods transactions were carried out within the framework of bilateral payments agreements, which because of the shortage of international reserves of gold and convertible currencies had become the basic instruments for the financing of trade among non-dollar countries. These agreements were usually negotiated for periods averaging one to three years and provided for swing credits to cover short-term trade fluctuations. All balances in excess of the swing credits were to be settled immediately or within a stipulated period ranging from three months to one year. Despite provisions relating to the settlement of such balances, creditor countries in several instances permitted the accumulation by their debtor of substantial balances in excess of the swing credits initially stipulated, and in order to maintain a normal flow of exports, they agreed to negotiate consolidation agreements with certain countries rescheduling repayment of these short-term debts over a longer period.

1/ The present annex is based in its substance and text on a U.N. Report "Export Credits for the Financing of Capital Goods Requirements of Developing Countries (Document E/4189)." The use of this document is by courtesy of the Fiscal and Financial Branch, Department of Economic and Social Affairs, United Nations.

The accumulation of excess debit balances and their subsequent renegotiation proved unsatisfactory to both creditor and debtor countries. Governments of creditor countries facing balance-of-payments difficulties, in convertible currencies, were obliged to commit resources abroad for periods exceeding those originally agreed upon; these conditions constrained the conduct of operations by monetary authorities in their management of domestic policies. For the debtor countries, debt renegotiation often led to a lowering of their credit rating and a consequent increase in the cost of new borrowing. This situation hastened the transition to organized medium-term credit systems.

At the beginning of 1950, the "Bank Deutscher Lander" established a rediscount line at the disposal of the "Kreditanstalt fur Wiederaufbau" (Reconstruction Loan Corporation) for the refinancing of export credits of up to four years. In March of the same year, France organized a medium-term export credit financing system for two to five years, based on the existing scheme for financing medium-term domestic transactions. In October 1950 in Belgium, the "Institut de Reescompte et de Garantie" earmarked funds for the financing of export credits of up to five years. In 1952, the United Kingdom extended the maximum export credit period for transactions with purchasers outside the sterling area to three years, or in the case of exports of national interest, to four or five years. (Prior to that time, credits exceeding six months for such transactions had been subject to the approval of the Foreign Exchange Control Commission; half the contract price had had to be paid within six months and the rest within two years.) In 1953, Italy introduced medium-term export credits of between one and five years, entrusting the operations to the specialized institutions engaged in the granting of medium-term domestic credit. Four to five years thus became a generally accepted maximum maturity for medium-term export credits.

The organization of medium-term export credit facilities was complemented by the extension to medium-term export credits of insurance schemes, originally introduced after the First World War for short-term transactions. In this way, Governments sought to transfer gradually an increasing share of export financing to the supplier, or to private banks, thus reducing progressively reliance on bilateral agreements.

This situation frequently led to an overemphasis on the credit factor by purchasers on capital goods transactions. Some purchasers lacking ready cash or easier access to their own banks were induced to ignore higher prices or inferior quality in their endeavour to secure more advantageous credit terms from their suppliers. Such terms became in fact increasingly available, as the sellers' market for capital goods gradually developed into a buyers' market, as a result of the recovery of the economies of Western Europe and Japan.

Toward the middle of the 1950's, the export credit insurance institutions in the major exporting countries organized through the

"Union d'Assureurs des Credits Internationaux" (Berne Union), 1/ the international association of credit insurers, direct exchanges of views leading to concerted action relating to the duration of export credit insurance cover, which determined the duration of credits. They reached an understanding that export credit insurance should not exceed five years for heavy capital goods. They also agreed that purchasers of capital goods should make a reasonable down payment before or upon delivery of goods.

These limitations were designed to arrest a trend toward competitive easing of credit terms in the buyers' market then emerging for capital goods. Such a trend was made acute by the aggressive sale policies of suppliers interested in penetrating new markets, as well as by the pressure of developing countries to obtain credit maturities more compatible with their development needs, tempo of growth and existing and potential external resources. The lengthening of maturities was increasingly facilitated or offered by the authorities of countries tying their bilateral development loans to procurement from national suppliers.

From the mid-1950's onwards, exporters in almost all Western European countries began exerting pressure on their governments for export credit insurance exceeding five years. The reason generally advanced was that the Export-Import Bank of Washington (which was not then a member of the Berne Union), through its long-term project loans granted directly to purchasers in developing countries, was in fact enabling American exporters to sell on terms which European suppliers could offer only if they could obtain long-term credit insurance to cover bank re-financing on similar terms.

Exporters in the countries of continental Europe accentuated their pressure when in 1957 the United Kingdom decided to expand the volume of long-term financing assistance granted under the Export Guarantee Act of 1949, which stipulated that official funds allocated under this program must be utilized for the purchase of United Kingdom goods and services. One year later, the United States, under increased strain on its reserves, decided that Development Loan Fund loans and grants should in principle be tied to specific purchases of American goods and similar policies were adopted by other industrial countries. Thus, exporters in the leading countries received indirect support through the tied financing extended by their governments to overseas purchasers.

This situation resulted in departures from the understanding that export credit maturities should be kept within the Berne Union limits (the Union was notified of three such departures in 1957, four

1/ Created in 1934 chiefly as a clearing-house for exchanges of views on insurance techniques and information related to credit ratings. See Annex IV.

in 1958 and six in 1959). In a number of countries whose governments were unwilling or unable to provide development loans - tied or untied - and whose exporters were faced with competition from such loans, new interpretations of the five-year understanding were put forward. The most significant narrowed the application of the five-year understanding to guarantees given to suppliers; where guarantees were given in respect of credits granted directly to buyers in developing countries, for the purchase in the credit-supplying country of heavy capital goods needed for development projects, such guarantees remained outside the scope of the understanding. As a matter of fact, this type of guarantee usually involved substantial amounts, which could not reasonably be expected to be reimbursed over five years, in view of the developing countries' financial situation and the normal amortization period for such goods.

Other interpretations designed to soften the maturity terms related to the starting point for the five-year limit and the down payment by the purchaser. As regards the former, the failure of the original understanding to specify the starting point from which the five years should be calculated made it possible to count the five years from the time of delivery of the last part of the order, thus stretching the ceiling to seven or eight years, since one to three years might well elapse between the first and last deliveries.

In 1961 the Berne Union issued a precise definition of the starting point from which the five years were to be calculated. In the case of capital goods consisting of individual usable items (for example, locomotives), the starting point for a single shipment was to be the date when the buyer took physical possession of the goods. Where the order consisted of several shipments the starting point was the "mean date" of the dates when the buyer took physical possession of the whole order. In the case of capital equipment for complete plants or factories, the starting point was to be the date when the buyer took physical possession of the entire equipment (excluding spare parts) supplied under the contract; in the case of construction or installation contracts, the starting point was to be the date when the seller had completed the construction or installation of the plant. In the case of such construction or installation contracts, guarantees could also run for six years from the date when the entire equipment was delivered to the site. In addition, certain countries re-interpreted a Berne Union understanding requiring an appropriate down-payment to the effect that such down-payments could be lower than those originally stipulated.

In a gradually increasing number of cases since the late 1950's, export credits have thus been granted and insured on easier and longer terms and for a greater variety of purposes thus blurring the distinction between trade and aid.

ANNEX III

Characteristics of Export Credit Insurance and Private Export Credit in Various Industrialized Countries

The purpose of this annex is to present a brief comparative account of the main features of export credit insurance and export credit in the principal industrialized countries. 1/

Comprehensive and detailed information on institutions and procedures, related to private export credits and their insurance in most industrialized countries, can be found in two major studies: a United Nations report entitled "Export Credits and Development Financing" (Publication No.: 67.II.D.1); and a survey published in March 1965 by the Bank for International Settlements, entitled "Export Credit Insurance and Export Credits." These two documents cover Australia, Belgium, Canada, Denmark, France, the Federal Republic of Germany, Italy, Japan, the Netherlands, Norway, Sweden, Switzerland, the United Kingdom and the United States. In addition the United Nations' report also covers Czechoslovakia, Poland and the USSR.

1/ The terms "private export credit" relate to both suppliers' and buyers' credits. Supplier's credit is a form of trade credit extended by the supplier in one country to the buyer in another country. The supplier may or may not obtain financing of the credit from a bank. Bank financing is usually limited to the amount insured by an export credit insurance institution. Buyer's credit, also known as financial credit, is export credit extended by a bank to the importing buyer. This credit is ordinarily limited in its use to purchase of particular goods, from a specified supplier or list of suppliers. The supplier is paid in cash by the importer; he may, in fact, sometimes obtain payment directly from the bank on proof of shipment.

Export credit insurance is insurance provided against various losses related to credits granted for the export of goods. With at least one exception (financial credits by the German Kreditanstalt fur Wiederaufbau) public credits are not insured, the State itself taking the risk.

Short-, medium- and long-term concepts, vary from country to country. As a general rule, any operation with maturity falling within a year is considered short, although short-term is at times confined to six months only. One-year credits are included by some countries in short, by others in medium-term. One-to-five years credits are usually classified as medium, those over five years as long-term financing.

A review of institutions and practices in these countries indicates that, with respect to export credit insurance, there is a basic similarity in the various national schemes, and that differences between them tend to be reduced by international competition and co-operation. Export credit systems, on the other hand, have widely different features, and these differences tend to persist, since export credit is linked in each country to its domestic credit structure.

The origins of export credit insurance date back to the period immediately following World War I. In Great Britain, whose insurance methods have tended to serve as a model for many other countries, a private export credit insurance entity was set up in 1918, and the State first entered the field in 1919. Between 1922 and 1934, export credit insurance schemes were introduced in 14 other European countries. The period between the two World Wars was largely experimental. Initial cover of risk was as low as 60 percent, for instance, in France and Germany. The British progressively extended export credit insurance from short-term to medium-term (1928), from insurance of individual transactions to guarantees for the whole export turnover (1932), and from commercial to political risks (1935). Since the Second World War, most of the existing institutions have been reorganized and expanded and new ones have been established in industrialized countries in which they did not exist. Export credit insurance procedures are constantly being modified to conform to changing circumstances. This annex will attempt to outline the basic analogies of national schemes by describing the standard features of a typical scheme, while signalling the main differences of details as applied by various countries, particularly the United Kingdom, the United States and Italy.

Export credits, on the other hand, were organized within the framework of established national credit systems, and though some adaptations have been made to meet special problems of export or of competition, they reflect the basic features of national credit systems. The summary description, given in this annex, of the export credit structures in five of the main industrialized countries (United Kingdom, United States, France, the Federal Republic of Germany, and Italy), will show the large differences between them.

I. Export Credit Insurance

A. The common features of a typical scheme

Common features in the forms of insurance provided by exporting countries are found in the categories of risks covered, the nature of the transactions insured, the types of policy, the risk cover, the cost of insurance, and the beneficiaries. Finally, it will be indicated how, though the institutions differ, the administrative procedures are similar in various countries.

1. Categories of risks

A distinction is generally made between commercial risks and non-commercial risks.

Commercial risks include insolvency (always), protracted default (with the exception of Belgium and Germany), and, in most countries, non-acceptance of the goods or repudiation of the contract.

Non-commercial risks always include political risks, which are related to any government action in the buyer's country, which prevents or delays payment beyond stipulated periods, and the transfer risk, resulting from non-availability of foreign exchange. They sometimes include also the risks of natural catastrophe, the exchange rate risk, the economic risk related to increased costs during the production period (in France and Italy), and transportation difficulties.

What falls under commercial risk when the buyer is private is always, with the exception of the United States, considered as a political risk when the buyer is a government or a public body.

2. Transactions insured

Export credit insurance covers the export of all types of goods and a variety of services. All goods are eligible for insurance, provided they contain a minimum proportion of national material and labor. 1/ For instance, within the European Economic Community, a foreign content up to 30 percent was allowed in May 1962, and was increased to 40 percent (under certain conditions) in 1965. By agreements between insurance companies, the foreign component is insured in the country of the main exporter. Insurance is also available for consignments and stocks held abroad, and for a variety of services, such as contract work abroad and advisory services. The cost of the study and preparation of projects is covered in Denmark, Italy and Japan. Expenditures incurred in the exploration of foreign markets are covered by France and the United Kingdom.

3. Types of policy

The two basic types of policy are the whole-turnover policy, also called the global or comprehensive policy, and the specific policy.

The whole-turnover policy is an obligation to the exporter to insure all his exports during a given period, at least to one market, and for the categories of goods considered suitable. Its usual application is to consumer or semi-manufactured goods, sold in a continuous

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1/ Some countries cover goods of foreign origin, but on short-term credits only.

or repetitive way, on rather short credit terms. Its justification is the spreading of risk over a larger volume of business, avoiding discretionary selection of insurable risks by exporters, and contributing to a lowering of premiums.

Specific policies cover individual contracts. Their most usual application is to the export of capital goods, which need long manufacturing periods and long terms of payment.

4. The risk cover

The requirement that the exporter carry the risk of a small percentage of the credit for his own account is general to all credit insurers. It is aimed at discouraging irresponsible trading, at ensuring that the exporter will pursue the defaulting debtor without delay, and at giving the exporter an interest in maximizing recoveries in the event of a default. Over the years there has been a general and steady tendency to increase the percentage of credits which may be covered by insurance. Countries belonging to the European Economic Community agreed, in May 1962, to limit the maximum cover to 90 percent in the case of supplier's credits.

Special cases in which a 100 percent cover is granted to the exporter or to the banker are described below, mainly in the section on the United Kingdom.

As a rule, the cover for risks which are beyond the control of the exporter, such as political and natural catastrophe risks, is higher than for commercial risks. Normal cover ranges from 70 percent to 90 percent for commercial risk and from 85 percent to 95 percent for noncommercial risk. Cover for losses on credits related to the holding of stocks abroad and the penetration of foreign markets is generally lower.

Cover is also reduced for exports to countries which offer relatively poor risks.

5. Beneficiary of the insurance

The beneficiary of credit insurance may be either the supplier or the bank, as in the three following cases:

i) Insurance given to the supplier in the case of a supplier's credit. This is the usual method. The insurance is often assigned by the supplier to the bank as collateral for the credit extended on the export transaction.

ii) Insurance given to the bank in the case of a supplier's credit. This is usually called a "bank guarantee." It allows the bank to grant to the supplier a "non-recourse" credit, which means that, in case of default by the importer, the bank will be directly reimbursed by the credit insurance company, without having to claim a refund from the exporter in any circumstances. It protects the bank in cases where non-payment, or non-acceptance of the goods, by the importer is due to a failure on the part of the supplier to comply with the terms of the contract. It also protects the bank against the bankruptcy of the exporter, or the loss of interest between the normal date of payment and the date of compensation by the insurance company.

Since non-recourse financing can be provided without regard to the supplier's assets, it has the advantage of leaving unimpaired the capacity of the supplier to borrow for his other needs.

An export transaction sometimes can be covered at the same time by insurance given to the exporter, and a guarantee given to his bank. The export credit insurance company might retain recourse to the exporter for claims paid under the bank guarantee and not covered by the exporter's insurance.

iii) Insurance given to the bank in the case of a buyer's credit. Insurance of a buyer's credit is called a "financial guarantee" in several countries. The bank extending a credit directly to the importer is naturally the beneficiary of the guarantee. The exporter bears the risk of the part of the transaction not covered by the buyer's credit, if any. He is also responsible for losses due to any faulty execution of the contract on his part.

6. Institutions, procedures and policies

The nature of the export credit insurance institution varies considerably from country to country. It may be a private, semi-public or public institution, or a section of the government administration. 1/ But it seems that the nature of the institution has little influence on its policies and procedures. For instance, the State is always financially responsible for political risks, and the policy with respect to such risks is always shaped by decisions of Government officials, or of bodies in which Government representatives are preponderant.

1/ Details on the institutions may be found in the UN and BIS studies referred to above. Legislative texts are reproduced in the BIS study.

On the other hand, it is agreed in all countries that commercial risks must be insured on a business basis. All insurance companies recognize the need to pay their way and build appropriate reserves. Within the Berne Union (see Annex IV) the companies exercise a mutual control to avoid any permanent subsidy to exports in the form of excessively low premium rates.

7. Cost of insurance and credit

Under the pressure of competition, insurance companies tend to bring down the cost of insurance on export credits as low as compatible with sound management. This cost is generally kept under one percent, and may be as low as 0.1 percent a year. The cost of bank lending for medium and long-term normally ranges from 5.50 percent to 7.50 percent. When domestic credit interest rates are higher, usually some kind of subsidy is granted to export credit for the sake of competition. When the total cost of finance (interest and insurance) available on an insured export transaction is lower than the rate normally charged in that country for comparable uninsured export credits, it can be said that the actual cost of insurance is negative - that is, the protection offered by the system gives rise to a net marginal benefit on the transaction.

Though the real costs of insurance and credit are rather well known in each exporting country, they sometimes do not appear in the terms of the transaction, and may be blurred for the importer. Exporters, for instance, may increase the attractiveness of their offers by incorporating part of these costs in the price of the goods.

B. Special national features

1. The United Kingdom

The Export Credits Guarantee Department (ECGD), which is a department of the Board of Trade, is the largest export credit insurance institution in the world. It covers, on short or longer terms, approximately 25 percent of all British exports, whereas the proportion of insured exports to total exports in other countries varies to a maximum of 10 percent.

Due to its volume of business, and the British experience in the fields of trade, insurance and finance, ECGD has developed an elaborate doctrine of export-credit insurance, which is used as a guide by many countries. It has also pioneered in this field in many ways.

For instance, while maintaining as a cardinal principle of credit insurance that the policy holder should bear a share of risk for his own account, the United Kingdom was the first country to establish a 100 percent cover, specifically, in the following three cases:

i) "Bank Guarantees," given to financing banks as a supplement to insurance cover for certain supplier credit contracts. The percentage of cover for "Bank Guarantees" was raised in January 1965 from 90 to 100. 1/ The "Bank Guarantee" comes into operation only after the goods have been shipped. It is unconditional, and the bank renounces recourse to the exporter. But ECGD retains recourse to the exporter for any sums paid to the bank, for which there is no liability under the credit insurance obtained by the exporter. This might occur because the cover granted to the exporter is partial, whereas the cover to the bank is total. It might also occur where non-receipt of payment was due to a cause not covered by the insurance, or when the exporter had by some act or omission released ECGD from liability.

ii) "Financial Guarantees," established in April 1961, cover 100 percent of capital and interest under loans extended to overseas buyers by commercial banks. They apply to large capital projects costing at least £ 2 million, or £ 1 million in the case of ships. It is a condition for the issue of such a guarantee that the loan shall be for only a portion, normally 80 percent, of the contract price. The suppliers must carry the risk on the remainder. This usually means that, under this scheme, they are not covered for the progress payments expected during the period of construction. Moreover, ECGD retains a right of recourse to the exporter if a claim has to be paid to the lender at a time when the exporter is in default under his supply contract.

iii) ECGD established in February 1962 a "full percentage facility" for "trouble-free" contracts. Under this facility, the percentage of cover given to the policy holder in respect of a contract on supplier credit of three years or more may be increased to 100 percent one year

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1/ The maximum cover of bank guarantees was 85 percent in 1954, when the system was introduced. It applied to contracts of more than £ 250,000. The cover was raised to 90 percent in 1958 and 100 percent in January 1965. The minimum amount of the contract was lowered to £ 100,000 in 1958 and £ 25,000 in January 1965, and was abolished in March 1966 for credits of two years or longer.

after full completion by the exporter of his performance of the contract, provided that the contract was entirely free from trouble and is likely to remain so. 1/

While in most other countries the commercial risk is either handled by institutions separate from the one which covers political risk, or is governed by separate rules, or can be covered independently from the non-commercial risk, British insurance policies always cover commercial and non-commercial risk at the same time.

2. The United States

The proportion of United States export credits, of both short and longer term, covered either by an "insurance" given to an exporter, or by a "guarantee" given to a bank, to total United States exports is around three percent, as compared to 25 percent for the United Kingdom. There are several reasons for this wide discrepancy. United States corporations are larger and more self-sufficient financially, and their foreign sales represent a considerably smaller proportion of their total business than in the case of their British (and other European) counterparts. They are, therefore, better able to be self-insurers of their own credits. Another factor is the relatively higher proportion of commodities in United States exports, as compared with those of the United Kingdom, which have a higher proportion of manufactured products, for which the credit insurance schemes are particularly designed. United States exporters have also enjoyed traditionally easier financing facilities - freer access to credits from commercial banks at lower costs, and greater availability of export financing from Federal agencies.

Export credit insurance is particularly recent in the United States. The present system was established progressively from 1960 onward. Under its provisions, short-term credits can be covered only by "insurance," while medium and long-term credits can be covered through the "insurance" program, and also through different types of bank "guarantees."

The United States credit "insurance" program is carried out by the Foreign Credit Insurance Association (FCIA), in collaboration with the Export-Import Bank. FCIA is a voluntary group of private insurance companies, which started functioning in February 1962 and now has more than 70 participants. FCIA covers commercial risks, with reinsurance of the larger risks by the Export-Import Bank. Political risks are assumed wholly by the Export-Import Bank. The United States "insurance" program is along the lines of the typical scheme outlined above.

1/ There are few other countries which have thus far applied any kind of 100 percent cover. South Africa has in some respects followed the example of ECGD. In the United States, the Foreign Insurance Credit Association has recently introduced a total cover for trouble-free contracts and the Export-Import Bank's financial guarantees have provided commercial banks a 100 percent cover.

There are three types of bank "guarantees":

i) Under a "financial guarantee" initiated in 1962, the Export-Import Bank in the past extended a full cover to direct lending by commercial banks. The total amount of such guarantees was relatively modest. They were generally related to transactions brought directly to the Export-Import Bank by a potential borrower and turned over to commercial banks, with a split of interest. The commercial banks, benefiting from a full guarantee, were not allowed to receive a return higher than 4.5 percent or 4.75 percent out of a maximum interest rate of 5.5 percent. This system has been in difficulties since market rates have risen, while the Export-Import Bank has kept its official rates stable.

ii) As an alternative, the Export-Import Bank announced, on April 26, 1966, a new system of financial guarantees for direct bank lending to borrowers abroad. Under this scheme, the commercial bank must carry the early instalments up to 30 percent for its own account, without either a political or a commercial risk guarantee from the Export-Import Bank or the FCIA on those instalments. It receives an unconditional guarantee on all later instalments, the interest rate being covered only up to six percent. The Export-Import Bank does not require a cash payment by the buyer or a risk participation by the supplier for such guarantee.

iii) Commercial bank lending to the exporters without recourse is eligible for the medium-term bank guarantee program. The commercial bank receives a guarantee for political risks in respect of all maturities, and for commercial risks in respect of the later maturities. Early maturities are defined as the first half of the instalments of a credit under three years, or the first 18 months of instalments on a credit of three years or over. The exporter is required to bear a part of the risk.

3. Italy

The basic law governing medium and long-term export credits and credit insurance was issued in Italy in 1953; this was successively revised by various laws, the most important one promulgated in 1961.

Medium and long-term export credits and credit insurance are granted by an autonomous official institution, the "Instituto Nazionale delle Assicurazione" (INA), which administers the insurance scheme on behalf of the State. Neither short-term export credits nor commercial risks are covered. The INA issues specific policies covering mainly capital goods and, exceptionally, consumer goods. The maximum length of the guaranteed credits was raised in 1961 from five years to "10 years or more."

State insurance may not extend beyond 85 percent of the amount of a credit related to sales of goods or services, and 30 percent of the value of a contract for works carried out abroad. The State guarantee may amount to 100 percent of financial credits granted in the case of long-term transactions related to assistance to developing countries. This provision, however, has had only limited application.

Short-term export credits can be insured by a private company, the "Societa Italiana Assicurazione Crediti," but only for sales to European countries. Modification of the existing laws, especially in order to allow the governmental insurance scheme to cover short and medium-term commercial risks, is currently under study.

4. Other countries

Export credit insurance in other countries conforms by and large to the standard pattern described above, with some noteworthy differences in individual countries.

In France, rules governing insurance have been adapted to new terms of maturity and to new procedures of financing adopted in the past few years, which will be described in the following section. In the case of "extended medium-term" credits, up to 10 years after delivery, insurance cover may reach 95 percent for the last maturities, provided it does not go beyond 85 percent for the first maturities, in order to keep the average cover within the 90 percent limit agreed by the European Economic Community. Cover for banks under the new procedures relating to buyers' credits may reach 95 percent.

In Austria, only specific policies are issued.

In Denmark and Sweden, the export credit insurance institutions usually issue only specific policies. However, a revolving policy may be issued for all short-term transactions of an exporter with a certain buyer.

Commercial risks are not covered in Switzerland.

In Japan, insurance to banks is provided on a global basis. Insurance to exporters is, as a rule, specific. However, whole turnover policies are available for a number of specified goods.

There are no substantial deviations from the typical scheme outlined above in export credit insurance as practiced by Belgium, Canada, Germany, the Netherlands and Norway.

C. Harmonization in suppliers' and buyers' credit insurance

From the above, it appears that there is already a fair degree of similarity in procedures followed by the various countries with respect to suppliers' export credit insurance. Moreover, a coordinating group in the European Economic Community is actively working towards the harmonization of export credit insurance in the member countries, the first objective being a common type of insurance policy for all members for medium-term credit to public buyers (see Annex IV).

The field in which the process of harmonization is least advanced is perhaps insurance for buyers' credits, which is a comparatively recent procedure. There are still significant differences between countries in the risk cover given in this respect to commercial banks and in the participation left to the exporter. For instance, commercial banks in the United Kingdom are not required to take any risk, but bank credit to buyers applies to a maximum of 80 percent of the amount, leaving the supplier to carry the other 20 percent of the transaction - roughly equivalent to the payments he is expected to receive during the production period. In Germany, the "financial guarantee" does not cover 100 percent, but the bank may transfer the non-covered portion to the exporter. On the other hand, no participation is required from suppliers in the United States, where commercial banks extending credits to buyers (under the system of financial guarantees introduced last April) are required to carry the commercial and political risks on the early instalments, up to 30 percent of the amount of the credit. Finally, in France, buyers' credits apply only to the post-shipment period, but the supplier can obtain 80 percent to 90 percent insurance cover for the production period; banks are expected to assume a five percent risk on their credit.

II. Export Credits

Short-term export credit is part of the ordinary business of commercial banks in all countries. The conduct of medium and long-term export credits differs widely from country to country, being more directly dependent upon availability of funds, domestic requirements and the structure of the financial markets.

1. The United Kingdom

The United Kingdom is endowed with money and capital markets distinguished for their advanced organization and capacity for adjustment. Funds are channeled through a great variety of financial institutions, such as clearing banks, discount houses, brokers, merchant banks and institutions specializing in long-term credit. These institutions are generally free of direct governmental regulation, and the Bank of England exercises its control and general guidance over them in a very flexible manner. As a consequence, they can adapt themselves easily to changing circumstances. In particular, the existing financing facilities have always been considered in Britain as adequate to meet the needs of traders for export credits.

However, the progressive lengthening of credit terms and banks' growing commitments in medium-term export finance have increased pressure on commercial banks' liquidity. The Bank of England has eased this pressure by means of the scheme introduced early in 1961. It now stands ready to refinance, at the rate of interest applicable to the original lending, either 30 percent of a bank's outstanding loans under export contracts insured by ECGD involving credit of two years or more, or the repayment instalments of such lending which would mature within 18 months, whichever is greater. Moreover, a provision that such eligible instalments may rank as liquid assets has so far precluded the need actually to make use of the facility. Early in 1962, a scheme was introduced under which fixed-rate finance was made available for contracts covered either by Bank Guarantees, for credit periods up to five years, or by Financial Guarantees, which cover longer term credit up to a normal maximum of 15 years (see I. B. 1. above). In the early years of this scheme the banks financed the first five years of the credit at 5.5 percent per annum, the remainder being put up by insurance companies at a fixed rate of 6.5 percent per annum through the Insurance Export Finance Company, formed for the purpose. The participation of the insurance companies was discontinued in January 1965, however, when the banks agreed, in the national interest, to provide funds at the fixed rate of 5.5 percent per annum for the total length of the financial credit. To enable the banks to undertake such commitments, the Bank of England announced that it would in future be prepared to refinance, also at the rate applicable to the original lending, the whole of the outstanding balance of an export credit five years or more after its origin. Such amounts, however, will not rank as liquid assets in the hands of the banks. The banks have informally given an assurance that they will not use this facility to obtain an interest advantage.

2. The United States

The capital market of the United States is larger than those of European countries, and is characterized by a greater abundance of funds 1/ and lower interest rates. As in the United Kingdom, financing is considered essentially a private business, and public credits are extended in principle only when private credits are not available.

Information on private export credits is limited. More than in any other country, large private concerns are not only their own insurers, as mentioned above, but also their own bankers. Bank credit

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1/ For instance, according to a study prepared in 1963 for the Joint Economic Committee of the U.S. Congress, the volume of U.S. gross issues of securities during 1962, with central government and foreign borrowing included, was from four to five times that of seven main European countries combined (Belgium, France, Germany, Italy, the Netherlands, Sweden, the United Kingdom).

to a company is usually related to its general activity and overall sales, without being identified by the lender as export credits. Moreover, many links exist between private firms or bankers in the United States and subsidiary companies, local banks, correspondents and importers in a number of foreign countries, particularly in Latin America. As a consequence, a large part of the credit extended for the sale of United States goods may reach the foreign importer without being reported as export credit.

Commercial bank credits related to United States exports appear only exceptionally to extend over a term as long as six or seven years, unless insured or guaranteed. 1/ The bulk of long-term export credit is in the form of public credits granted to foreign importers. The Export-Import Bank has exceptionally lent under five years for industrial goods since the Foreign Credit Insurance Association (FCIA) and its own program of guarantees to banks started functioning in February 1962. Its credits to developing countries are in the order of magnitude of \$500 million annually, compared to an annual volume of around \$200 million of insured or guaranteed medium-term credits to these countries.

Since 1965, the Export-Import Bank has also offered, for market distribution, certificates of participation in its own loan portfolio; such certificates, offered at the going rates and eligible as collateral for advances by the Federal Reserve Banks, have found favorable reception in the portfolios of commercial banks and other financial investors. Beginning in September 1966, the Export-Import Bank has offered additional facilities to assist banks carrying medium-term export credits and increasing their overall export financing. The Bank will make "one-year current export loans" to commercial banks, up to one-half of their outstanding medium-term export loans, i.e., those running more than six months to maturity. It will also make "net increase loans" up to one-half of the increase by a commercial bank of its total export financing, including short-term loans. The Export-Import Bank has indicated that the interest rate charged to the banks will vary with the degree of insurance or guarantee carried by the underlying export paper. Commercial banks making use of these facilities will be required to set aside in separate accounts the export loans

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1/ Bank guarantees are associated with a "put and call" system operating after seven years. This system allows the Export-Import Bank to prevent bankers from making excessive profits if the interest rate has gone down (call system). Conversely, commercial banks can transfer the lending to the Export-Import Bank if the rates have gone up (put system). One consequence is that the commercial banks do not hesitate to extend guaranteed loans over seven years. The practical limit of their export lending seems to be around 12 years.

involved. In view of their access to these facilities, commercial banks will be in a position to regard their export paper of short or intermediate maturities as liquid. The procedure used and the effect on the banks' liquidity explains the reference to this innovation as a "discounting program."

3. France

Fear of inflation, which has been continuous in France during long periods in the past, may be the main reason why private savers tend to prefer liquid assets to long-term investment. Another reason is perhaps the lack of significant yield differentials between short and long-term investments, after deduction of taxes. Transformation of liquid savings into medium and long-term investment is done by the banking system or the Treasury through a number of semi-public, public or publicly-controlled mechanisms. Such mechanisms have become one of the most efficient means at the disposal of the public authorities for influencing business decisions towards the accomplishment of national objectives.

Medium-term export credit has been organized along the lines of the special French medium-term credit system. Longer term credits have recently been authorized.

The medium-term credit system has been devised to slow down the recourse to Central Bank rediscounting, by interposing, between the borrower and the Central Bank, one more intermediary institution than required in the short-term credit rediscounting system. Moreover, the additional intermediary institution is entrusted with the technical evaluation of the transaction. In the case of medium-term export financing, promissory notes ("billets de mobilisation"), issued by the exporter to the order of his commercial bank, receive the unconditional guarantee of the "Banque Francaise du Commerce Exterieur," and are discountable with the "Credit National," whose prior approval of the credit must be obtained. Thus, they bear the four signatures requested for rediscount by the Banque de France.

In this system, medium-term export credits benefit from two advantages: they are outside the commercial bank rediscount ceilings, and they enjoy a preferential rate of rediscount with the Banque de France. Since they have to be insured in order to be eligible for this procedure and to benefit from the related advantages, all export credits over two years after delivery are insured.

Long-term credits have been made available by a law of 1960, which created a special Fund for Treasury loans to the "Credit National." The Fund is provided with resources by various means, under the supervision of the Treasury, such as loans from the "Caisses des Depots et Consignations." The Treasury is committed to cover any difference between interest rates paid and received by the Fund. This facility has been used to set up the "extended medium-term" credit system ("moyen-terme prolonge"), which covers the range from five to 10 years after delivery.

In order to alleviate the burden on the Fund, and to encourage the banks to engage in long-term financing, the creation of the "Groupement Interbancaire pour le Commerce Exterieur" (GICEX) was authorized in 1962. Each of the 17 participating banks committed itself to provide refinancing for transactions approved by the association up to a ceiling of either one percent of deposits or five percent of capital and reserves. In practice GICEX has financed the maturities over five years of loans of six-year or seven-year terms. Maturities over five years of loans with terms longer than seven years have been financed by the Fund.

Buyers' credits were authorized in France in 1965, in application of the 1960 law mentioned above. The loan granted directly to the importer applies to the period after delivery. It consists of a bank loan of a maximum term of five years, plus a loan by the "Banque Francaise du Commerce Exterieur" for all maturities over five years. The main objective of this procedure is to free the exporter of all participation in the financing and risk of very large transactions associated with the longest credit terms. It is intended that other aspects of the credit and of the insurance, such as the nature of eligible goods, terms of maturity, etc., be governed by rules similar to those applied to suppliers' credits.

Since 1960, France has blended suppliers' credits with governmental credits, which offer lower interest rates and longer terms. The proportion of governmental credit to the total was from one-fifth to one-third, until its maximum share was raised to 40 percent in 1966. Such blended credits may consist of parallel credits or of integrated credits.

In the case of parallel credits, suppliers' credits apply to the sales of equipment, while governmental credits are for other purposes, such as local expenses, infrastructure or complementary material.

In the case of integrated private and public credits, applying to the same transaction, a governmental credit may finance payments before delivery, while the balance is covered by suppliers' credits.

France's contribution to international consortium aid may take the form of subsidizing suppliers' credits, as in the case of India or Pakistan; the lowering of the interest rate is effected through the financing of "Credit National."

4. Germany

The German economy is characterized by a large proportion of business financing being obtained through short-term bank credits, which are renewed an indefinite number of times. Export financing follows the same pattern, at least for uninsured credits. Many credits granted by suppliers are made possible by the support they receive from commercial banks for their general activity without any special allocation of bank borrowing to export transactions. The export credit insurance helps the exporter in finding medium and long-term sources of credits more easily, through the banking system and specialized institutions.

Though there is no upper limit on the maturity terms of their loans, commercial banks are generally reluctant to grant credits of terms over four or five years. Longer terms are provided by two intermediary institutions, the Ausfuhrkredit-Gesellschaft (Export Credit Company), and the Kreditanstalt fur Wiederaufbau (Reconstruction Loan Corporation), which channel funds raised from various origins.

The Ausfuhrkredit-Gesellschaft (AKA) is a private company, established in 1952, with capital held by a bank consortium. The funds at its disposal come from two credit lines of different origin, called "A" and "B" lines. The "A" line is made available by the members of the consortium. Its limit was raised from DM 700 million to DM 1 billion late in 1965 and to DM 1.5 billion in 1966. The "B" line is a rediscount line at the Deutsche Bundesbank. Its limit was raised from DM 300 million to DM 900 million on July 22, 1966. It was formerly at the disposal of the Kreditanstalt fur Wiederaufbau, and was based on European Recovery Program counterpart funds.

Maximum terms of maturity are four years for credits on the "B" line, and eight years for credits on the "A" line. These eight years normally cover up to three years for production and up to five years after delivery. Interest rates on the "B" line are generally around 1.5 percentage points under interest rates on the "A" line (currently 6.5 percent instead of 8.25 percent). Conversely, the proportion of financing, and of risk left to the exporter, is higher on the "B" line.

The Kreditanstalt fur Wiederaufbau (KW) was established in 1948 as a public body for financing reconstruction. It was entrusted in 1950 with the task of providing medium-term export credits up to four years. This task was transferred to AKA when that institution was founded, but the KW, owing to the fact that its funds could be lent on a long-term basis, continued to participate in the export financing process by providing "follow-up financing," i.e., it finances credit maturities exceeding the ceiling imposed by AKA regulations for up to 10 years after delivery. Since 1961 the Kreditanstalt has been granting long-term loans to foreign purchasers in developing countries. This procedure applies generally only to large projects of a minimum value of DM 5 million.

Since 1961, KW has also become an executing agency for the German foreign assistance program, financed by public funds. For transactions carried out on its own behalf, i.e., export financing and the provision of loans to foreigners on conventional terms to supplement official development aid, KW uses its own capital and funds borrowed on the capital market or from other sources, especially public and private institutional investors.

Germany, like France, has initiated blended suppliers' and governmental credits, but, in contrast with France, the major share is taken up by governmental credits. One of the objectives is to spread the use of limited public funds.

5. Italy

As in the case of France, a high preference for liquidity has induced the Italian public to place its savings in accounts with banking institutions. As a result, the capital market is concentrated in large institutions, acting as investors of their own funds, and in dealers placing long-term securities with their clients.

The Italian Banking Law of 1936 separated ordinary or short-term commercial bank credit from medium and long-term credit, which is the responsibility of special credit institutions. As mentioned earlier, medium and long-term export credits are regulated by special legislation, principally by laws issued in 1953 and 1961.

The special credit institutions in charge of medium and long-term credits are, for the most part, public law entities, special sections of six public-law banks, and saving banks authorized to engage in special types of credit activity.

They comprise three separate groups of credit institutions, one for Northern and Central Italy, one for Southern Italy, and a third which includes the major industrial credit institutions whose operations are not subject to territorial or qualitative limitation. This third group includes the "Istituto Mobiliare Italiano" (IMI), Mediobanca, Centrobanca, Efibanca, Interbanca, departments of the "Banca Nazionale del Lavoro," and the "Instituto di Credito per le Imprese di Pubblica Utilita."

Export credit is granted almost exclusively by IMI, Mediobanca, and Efibanca. Of all the institutions mentioned, only IMI grants credit at long term. These specialized institutions obtain their resources, besides their own capital, mostly through long-term obligations, and also from Treasury funds, credit lines at commercial banks, demand and savings deposits, and foreign borrowing.

These obligations are absorbed by various categories of subscribers, such as banking institutions, provident and insurance institutions, the "Cassa Depositi e Prestiti," and the general public;

the Banca d'Italia has occasionally operated in these obligations. The pattern of distribution among the various investors varies from year to year, sometimes to a considerable extent.

IMI, a public law entity, obtains funds mainly through the issue of obligations and sometimes (as in 1964) has been the main channel of foreign loans. The other four institutions mentioned above - Mediobanca, Efibanca, Centrobanca, and Interbanca - are joint stock companies which obtain medium-term savings mainly by means of tied deposits and interest-bearing bonds.

Export financing in Italy, like domestic medium-term financing, is of a mixed public-private nature. The juridical status of the institutions is not of great significance, since they all operate on autonomous and commercial principles. More important is the mixed origin, partly public and partly private, of their resources. Furthermore, all export financing operations receive State assistance through the Mediocreditor Centrale. This public institution can refinance insured credits financed in the first instance by specialized institutions, at a preferential rate. Due to the shortage of funds, it often prefers to subsidize directly the interest rates of the first instance institutions.

Under the present system there is no institution specializing in export financing. Public and private institutions conduct their export transactions in competition with domestic allocation of credit resources. As a consequence, exporters sometimes find it difficult to secure advance commitments as to the amount and terms of export financing.

The 1961 legislation provides for buyers' credits to public entities or to private purchasers abroad with the guarantee of their government. These provisions have been applied so far only to a limited extent.

Amendments to the laws governing export credit insurance and export credit are under consideration.

ANNEX IV

Organized Cooperation Among Creditor Countries

Policies and practices related to export credits have been influenced by the activities of several international groups concerned with various aspects of coordination in the field. This annex gives a summary account of the composition and achievements of the following groups:

- The "Berne Union" (Union d'Assureurs des Credits Internationaux)

- The "Groupe de Co-ordination des Politiques d'Assurance-credit, des Garanties et des Credits Financiers," of the European Economic Community.

- Two OECD groups, concerned with export credits and financial aspects of development assistance.

- Debt rescheduling "clubs" and technical assistance from international organizations.

Consortia sponsored by the OECD or by the World Bank, and consultative groups sponsored by the World Bank or by the Inter-American Development Bank, are concerned primarily with long-term public development finance, although the terms of private credits, as they affect the recipient countries, are also frequently the subject of consultation.

A. The "Berne Union"

The "Union d'Assureurs des Credits Internationaux," usually referred to as the "Berne Union" was established in 1934. Today it has 26 full members, which are private and public export credit insurance institutions. After the Second World War, the Berne Union played the leading role in the attempt to establish orderly processes in export credit competition (see Annex II). It was hampered by several factors, including the following:

1) Membership: The Export-Import Bank of the United States was an observer until January 1962, when it became a full member, in its capacity as insurer. Japan, in which export credit insurance is undertaken directly by the Ministry of International Trade and Industry, is not a member.

2) Scope: The "understandings" of the Berne Union do not cover buyers' credits.

3) Authority: Understandings between members are not binding, but prevail only as long as there is sufficient mutual interest to maintain them. Moreover, understandings can be overridden by individual government decisions or directives, since governments are not represented in the Union.

Since 1961, the Union has expressed the hope that a system of international coordination would prevent the deterioration of credit terms. In 1965 it again stressed the responsibility of governments towards solving the problems of competition, offering its technical assistance to that end. Its technical subcommittee worked effectively on a wide range of problems, including a better understanding among members of their individual practices and nomenclature. The Union established an informal pooling of information on the credit ceilings set forth by creditors for "problem" debtor countries and, in January 1965, conducted a "test run" for a Central Information Pool.

B. The "Groupe de Co-ordination des Politiques d'Assurance-credit des Garanties et des Credits Financiers," of the European Economic Community

The "Coordinating Group for Policies of Credit Insurance, Guarantees and Financial Credits" (referred to hereunder as the Coordinating Group) was created on September 27, 1960, and began operating in 1961. It consists of representatives of Ministries of Finance and of, Economics and of credit insurance companies of the six countries of the Common Market. It meets approximately every other month, and maintains continual communication between meetings. It has worked in the three following directions:

1. Harmonization of credit insurance contracts.

The work of the Technical Committee entrusted with this task is well advanced. A draft of a common insurance contract for sales to public buyers is scheduled to be transmitted to the Coordinating Group by the end of 1966. The agenda for further work includes the harmonization of short-term guarantees, a common insurance contract for medium-term credit to private buyers, and another for public works contracts. The objective is to unify the conditions of competition, and also to create an instrument for a common policy in the future.

2. Tightening of coordination among members.

A procedure of consultation was instituted by a Council decision of May 16, 1962, covering credit guarantees for long-term suppliers' credits and private financial credits (over five years after delivery). It was extended by a Council decision of January 26, 1965, to global credits ("enveloppes globales de credits") and guaranteed private lines of credit. Agreements associating public funds and suppliers' credits or private financial credits (matters which have involved political problems), are subject to a special procedure of consultation in the Committee of Permanent Representatives in the Common Market.

The procedure of consultation instituted in 1962 provides that a credit guarantee for a long-term transaction may be given at the earliest seven days after consultation with the other countries. Within these seven days any member has the possibility to comment that particular transaction or, if it disagrees, could call for a meeting of the co-ordinating group, with the objective of pressing for withdrawal of the special terms. The 1965 decision provided that, except in case of urgency, the transaction had to be suspended until the next meeting of the Co-ordinating Group if, after seven days, five of the six members were against the contemplated transaction.

3. Criteria on maturities.

The Co-ordinating Group worked to establish a set of criteria on maturities of credits over five years, providing that:

a) The Berne Union understandings should be respected for exports to developed countries.

b) Credits over five years could be considered for developing countries, subject to consultation, in cases where the proposed exports would meet one or another of the following criteria:

- be part of a project in a development plan;
- be within the framework of an aid consortium;
- be part of a project approved by an international organization;
- be of large magnitude; or
- be of exceptional significance for the exporting country, for instance, for reasons of regional policy.

The Group also tried to establish the criterion that the maturity of credits should be tailored to the category of goods involved, taking into account the useful life of the equipment. The formulation of this principle has proved to be particularly difficult.

The success of this Group has been impaired by the limited number of exporting countries involved. It did not succeed in persuading OECD to adopt any of these principles. Members of the Common Market continued to deviate from the proposed rules in order to compete with outsiders. The Group succeeded in obtaining a satisfactory exchange of information, but appears to have fallen short of its objective as concerns control of competition. The discussion of guidelines for co-ordination appears to have been discontinued in 1964.

C. OECD Groups

The Organization for Economic Cooperation and Development has two groups concerned with suppliers' credits, in both of which the Commission of the European Economic Community is represented. They are:

1. The High Level Group on Export Credits and Export Credit Guarantees, created by the Trade Committee in 1963. This Group is made up of senior officials with major responsibility in the formulation of policies in this field, and of senior officials of the export credit and credit-guarantee institutions. Some of its members are mainly interested in the limitation of competition among industrialized countries. In February 1963, the Working Group submitted to the Trade Committee a proposal for a co-ordinating arrangement among members for credits over five years, including prior information and a "question and answer" procedure. Members would be bound to answer questions raised by other countries relating to export credits and their insurance.

2. The Development Assistance Committee's Working Party on the Financial Aspects of Development Assistance, which is concerned with the problems of indebtedness and appropriate financial terms and conditions.

On November 9, 1964, the Netherlands submitted what has been called the "Neutral Area" proposal, providing a "no man's land" between trade credits, which should have a maximum repayment period up to ten years, and tied aid credits, which should have a minimum maturity of fifteen years. The proposal has been considered by the Working Party of the DAC, and has been referred to the Working Group of the Trade Committee for further consideration.

D. Debt rescheduling clubs and technical assistance from International Organizations

In recent years, when a debtor country has requested a rescheduling of debt, the main creditors concerned have found it convenient to assemble in the so-called "Hague Club" and "Paris Club," in order to attain unity of action. The objectives have been to ensure that the burden of refinancing would be shared equitably among creditors, and to adopt a common position towards the debtor country.

In general, creditor countries have emphasized their view that a debt renegotiation must be considered a very unusual event. Accordingly, when a second approach has been made by a debtor country, more emphasis has been placed on avoiding a recurrence of the problem.

Since the creditors assembled in a club usually represent the major part of possible credit facilities, they should, in acting collectively, be able to prevent the recurrence of over-indebtedness. In practice, cooperative arrangements without adequate co-ordination have not been effective. Consequently, increased attention has been paid to the safeguards that could be provided through the cooperation of the International Monetary Fund and of the International Bank for Reconstruction and Development.

Although the debtor usually can present an exposition of its balance of payments position, there is a decided advantage to both the debtor and the creditor if there can be an impartial presentation of the facts. The Fund is in a good position to provide such an analysis of the short-term balance of payments prospects, while the Bank is in a comparable position to assess longer-term development trends. The Fund provided this type of information on an informal basis as part of the negotiations with respect to the outstanding debts of Turkey in 1958-1959, Brazil in 1961 and 1964, Argentina in 1962 and 1965, Liberia in 1963, Indonesia in 1963, and Chile in 1965. In the last-mentioned instance, the Bank participated in the discussion.

The Fund has the opportunity to assist in preventing a recurrence of the need for debt renegotiation when a stand-by arrangement is being negotiated parallel to the debt refinancing. Mutual benefits can be derived from commitments given to the Fund under a stand-by arrangement, since if adequate measures to restore the payments balance are implemented, there can be some assurance that such problems as the accumulation of arrears will not recur.

Another method, not connected with a program supported by a stand-by arrangement with the Fund, may be illustrated by the role that the Fund was asked to play in the negotiations with Brazil in 1964. At that time, the creditors and Brazil agreed to ask the Fund to act as a channel for reporting to the creditors all information supplied by Brazil, concerning the observance by Brazil of agreed policy on the acceptance of suppliers' credits.

Some safeguards have also been taken against the accumulation of new medium-term suppliers' credits through understandings between the debtor and the creditors. Up to the present they have been mainly in the form of a commitment undertaken by the debtor not to increase, during a period of around 18 months, the outstanding amount of such credits under eight years of maturity.

ANNEX V

Aggregate Statistics on Suppliers' Credits

This Annex presents such aggregate quantitative data on private export credits as it has been possible to develop on the basis of existing information. The data are based on compilations by the OECD on the flow of financial resources to developing countries, on the statistical reporting system under which debtor countries regularly report on external debt to the World Bank, and to some extent on judgments which have been formed as a result of informal contacts by Bank staff with some of the principal creditor countries in the course of this study.

Although certain orders of magnitude may be indicated from these sets of data, they should be taken as being only suggestive. The data obtained from creditor sources cannot be fully reconciled with those from debtor sources. The data available from creditor sources refer to developing countries in the aggregate, and do not provide details to permit matching against the data for individual debtor countries. Furthermore, the coverage from the two types of sources overlaps to some extent but is different in certain other respects. Creditor reporting covers guaranteed export credits to both the public and the private sectors in debtor countries, while the debtor country reporting system covers the private sector of the debtor countries only insofar as private debts are publicly guaranteed by the debtor country. The guarantees on the creditor side may not be matched by the guarantees on the debtor side. Furthermore, considering the great extent to which private interests are involved on both sides, there are inherent difficulties in obtaining adequate reporting on the subject.

The Role of Private Export Credits in the Flow of External Financial Resources to Developing Countries

As indicated in Table 1, the net increase in private export credits to developing countries, wholly or partially guaranteed in creditor countries, amounted to $741 million in 1965. Such credits are estimated to represent roughly three-fourths of the total of private export credits to developing countries, including those entirely unguaranteed in creditor countries. Thus, the net increase for all private export credits, guaranteed and unguaranteed, may have amounted to close to $1 billion in that year, including some $250 million for unguaranteed credits.

Total receipts by developing countries of external financial resources of all types from all sources, net of amortization payments, are estimated by the OECD to have amounted to some $11 billion in 1965. The $1 billion net increase in private export credits thus represented somewhat less than 10 percent of the total. In comparison, official loans totaled $2.8 billion net in 1965, consisting of $2 billion of bilateral loans from countries which are members of the Development Assistance Committee (DAC) of the OECD and $800 million of loans from multilateral agencies.

Table 1

FLOW TO DEVELOPING COUNTRIES OF GUARANTEED PRIVATE EXPORT CREDITS AND OFFICIAL BILATERAL LOANS FROM DAC COUNTRIES, AND LOANS FROM MULTILATERAL AGENCIES, 1960 - 1965

(millions of dollars)

	Private export credits wholly or partially guaranteed, net			Official loans, bilateral and multilateral, net		
	Over 1 through 5 years	Over 5 Years	Total	Total of official bilateral and multilateral loans	Official bilateral loans	Multilateral loans
1960	370	93	463	916	648	268
1961	272	221	493	1,508	1,280	228
1962	236	399	635	1,671	1,301	370
1963	259	293	552	2,218	1,679	539
1964	348	533	881	2,213	1,581	632
1965	286	455	741	2,787	1,974	813

Note: Sources are DAC Chairman's Review 1966 for 1962-1965, and OECD, The Flow of Financial Resources to Less-Developed Countries 1956-1963, Paris, 1964, p.134 for 1960-1961. Official loans include all loans with a maturity of more than one year. The figures on export credits are annual net increases in outstanding amounts of guaranteed export credits, including the non-guaranteed part of these credits. The figures on official loans are gross disbursements less amortization payments. The country coverage for 1960-1961 is slightly different from that for the other years by virtue of the inclusion of Switzerland and the exclusion of Australia.

The increases in guaranteed private export credits have shown an upward trend since 1960, having risen from \$463 million in that year to \$741 million in 1965. The upward trend is accounted for entirely by increases in credits with a maturity of over five years. The shorter-term credits have tended to increase steadily at an average rate of about \$300 million per year, while the increase in those over five years rose from less than \$100 million in 1960 to \$455 million in 1965.

Nevertheless, official loans have been increasing at a markedly higher rate than private export credits. Their net volume in 1965 of \$2.8 billion was more than three times higher than the net amount of such loans of \$900 million in 1960, while the net amount of guaranteed private export credits in 1965 was only about 60 percent higher than their level in 1960.

The sources of guaranteed private export credits are preponderantly the countries of Western Europe (including the United Kingdom) and Japan, which are estimated to account for about 90 percent of the total flow. The balance of 10 percent comes largely from the United States. The bulk of loans to the developing countries from the United States is in the form of public aid as well as public trade credits.

Suppliers' Credits in the Outstanding Debt and Debt Service of Developing Countries

Information on the total external indebtedness and indebtedness arising from suppliers' credits for a sample of 36 countries, taken from the World Bank's debtor country reporting system, is given in Tables 2, 3 and 4 of this Annex.

Since 1951 the World Bank has been assembling a systematic body of information on the external debt of its borrowers. In general, it covers the outstanding amounts of, and service payments on, obligations with a maturity of one year or more of the public sector, and of the private sector if publicly guaranteed in the debtor country. This represents the most comprehensive coverage available of the public indebtedness position of developing countries. Information is collected for some 70 developing countries. Since the quality of the reporting is uneven, the situation has been estimated for 36 countries as of a single date, December 31, 1965.

Suppliers' credits as derived from this sytem mean specifically credits extended directly by the suppliers of goods. Financial credits to debtor countries reported under the debtor country reporting scheme are relatively few, and for these the data submitted do not always provide enough information to identify those credits specifically associated with the movement of goods. It has therefore been necessary to exclude them from the tabulations in this Annex. The data yielded by this system may also involve some understatement through the failure of reporting countries to include certain transactions which are in fact conceptually covered by the system. It has been found by direct investigation in certain countries, for example, that debt or guarantees of publicly owned banks are not included in the reporting. The reason may be a desire to minimize the statement of the extent of the country's public and publicly guaranteed external debt. This may be of particular significance in relation to suppliers' credits insofar as they are guaranteed by such publicly owned banks.

Outstanding Debt

The total estimated outstanding indebtedness of the 36 countries, amounting to $22.1 billion as of the end of 1965, represents some 61 percent of the total outstanding indebtedness of all developing countries. This is calculated on the basis of a level of total indebtedness for such countries now estimated at some $36.4 billion as of the end of 1965, compared to the $33 billion of total indebtedness at the end of 1964 estimated in the World Bank/IDA Annual Report for 1964/65 (pages 57-58).

Some of the data in Table 2 have been extrapolated to the end of the year from the data available in June 1966, on the basis of estimated repayments in the course of the year 1965.1/ The sample includes a number of countries with a substantial proportion of suppliers' credits in their total debt, such as Argentina, Brazil, Chile, Republic of China, Colombia, Ethiopia, Korea, Liberia, Mexico, Nigeria, Peru, Spain, Thailand, the United Arab Republic and Yugoslavia.

With respect to outstanding amounts, the 36-country sample shows $3.6 billion (including undisbursed) of suppliers' credits as of the end of 1965, or 16 percent of their total outstanding indebtedness of $22.1 billion. If 16 percent is applied to the $36.4 billion estimated as the value of total indebtedness of all developing countries at the end of 1965, an estimate of $5.8 billion is yielded for outstanding suppliers' credits for all such countries. If allowance is made for suppliers' credits not guaranteed in the debtor country, the total of outstanding suppliers' credits in developing countries may be considered to have amounted to about $7 billion.

Of the 36 countries, 17 had a ratio of suppliers' credits to total outstanding debt of more than 10 percent:

1/ The position for December 1965 was available in debt reports for only 15 countries; for the others, the data were extrapolated from December 1964 for 10 countries, from March 1965 for 1 country, and from June 1965 for 10 countries.

Ratio of Outstanding Suppliers' credits to total debt (%)	Number of countries
0 - 4.9	9
5.0 - 9.9	10
10.0 - 19.9	9
20.0 - 29.9	5
30.0 - 39.9	3
	36

Debt Service

With respect to service payments, the 36-country sample shows that estimated service on suppliers' credits in 1965 of some $850 million represented 32 percent of their service on total debt of some $2.7 billion. In absolute terms, the 32 percent ratio for the 36 countries with respect to service payments would amount to $1.4 billion if applied to the $4.3 billion of total service on public and publicly guaranteed debt estimated for developing countries as a whole in 1965.1/ Total service payments are probably close to $2 billion, if allowance is made for service on credits not guaranteed in the debtor countries.

Thus, the total service payments of the 36 countries on account of suppliers' credits during 1965 represented about 32 percent of their service payments on total indebtedness, while the ratio of outstanding suppliers' credits to total outstanding debt at the end of the year was only 16 percent. This, of course, reflects the relatively short maturities of suppliers' credits. The higher ratios for suppliers' credits with respect to service payments compared with the ratios for outstanding amounts is illustrated in a number of countries as follows:

1/ See "Trends and Outlook in Development Finance" in the World Bank/IDA Annual Report for fiscal year 1965-66.

Area & Country	Service Payments on Suppliers' Credits as a Percentage of Total Service Payments	Suppliers' Credits As a Percentage of Outstanding Indebtedness
Latin America		
Brazil	63	30
Chile	25	11
Peru	52	33
Asia		
Korea	90	39
Thailand	36	19
Africa		
Liberia	60	24
Nigeria	53	20
Europe, Middle East		
Spain	26	11
U.A.R.	24	15
Yugoslavia	49	35

Some countries, e.g., Argentina, constitute an exception to this phenomenon; their ratios of suppliers' credits in outstanding debt and in service payments are more closely in line. In the case of Argentina, this may be due to the rescheduling of service payments on suppliers' credits.

A frequency distribution shows that 22 of the 36 countries had a ratio of 20 percent or more between suppliers' credits service and service on total debt:

Ratio of Suppliers' Credits Service to Total Debt Service (%)	Number of Countries
0 - 4.9	5
5.0 - 9.9	2
10.0 - 19.9	7
20.0 - 29.9	12
30.0 - 39.9	2
40.0 - 49.9	2
50.0 - 59.9	2
60.0 +	4
	36

The ratios of service payments to commodity exports are shown for the 36 countries in Table 3. Overall, the service payments on total debt in 1965 represented 13.4 percent of the value of exports, including the component of 4.3 percent as the ratio for suppliers' credits. The service burden of suppliers' credits in relation to the value of exports is particularly noteworthy in the cases of Argentina, Brazil, Chile, Korea, Liberia, Mexico, Peru, Turkey, the U.A.R., and Yugoslavia.1/

Eighteen of the countries had a total debt service ratio of 10 percent or more, and ten countries a suppliers' credit service ratio of four percent or more.

Ratio of Total Debt Service to Commodity Exports (%)	Number of Countries
0 - 4.9	11
5.0 - 9.9	7
10.0 - 19.9	12
20.0 - 29.9	4
30.0	2
	36

Ratio of Suppliers' Credits Debt Service to Commodity Exports (%)	
0 - 0.9	10
1.0 - 1.9	6
2.0 - 2.9	8
3.0 - 3.9	2
4.0 - 4.9	5
5.0 - 9.9	4
10.0 +	1
	36

Repayment Rate

A schedule of projected service payments during the four years 1966-69 in relation to the outstanding amounts of indebtedness as of

1/ Data for exports of goods and services are not fully available for most of the 36 countries for the year 1965. Of the 10 countries cited above with a noteworthy service burden of suppliers' credits in relation to the value of commodity exports, exchange earnings from services are appreciable in the cases of five; Korea, Mexico, Turkey, the U.A.R., and Yugoslavia. The debt service ratios in relation to exports of both goods and services were therefore substantially lower than those indicated in Table 3 for the give countries.

the end of 1965 is shown in Table 4. This also illustrates the much shorter maturities of suppliers' credits. As shown in Table 4 for the 36 countries, the service payments during the four years on suppliers' credits amounted to 72 percent of the outstanding indebtedness in this type as of the end of 1965, while the corresponding ratio for total debt is about 45 percent.

The much shorter maturities of suppliers' credits than of total external debt is further illustrated in an investigation of debt incurred in 1964 by 34 developing countries.1/ The weighted average maturity of suppliers' credits incurred was approximately five years compared to 23 years for total debt.

1/ Including 25 of the countries covered in Tables 2-4, plus nine others. The 34 countries are Argentina, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Ethiopia, Guatemala, Honduras, India, Iran, Israel, Kenya, Malaysia, Mexico, Nicaragua, Nigeria, Pakistan, Panama, Paraguay, Peru, Philippines, Rhodesia, Spain, Sudan, Tanzania, Thailand, Turkey, Uganda, Uruguay, Venezuela, Yugoslavia, and Zambia. The debt of these countries represented 65 percent of the total outstanding debt of developing countries at the end of 1964. More detailed information on the weighted average terms of the debt incurred by these countries in 1964 may be found in the World Bank/IDA Annual Report for the fiscal year 1965-66.

Table 2

EXTERNAL MEDIUM AND LONG-TERM PUBLIC AND PUBLICLY GUARANTEED DEBT, a/ TOTAL AND SUPPLIERS' CREDITS: ESTIMATED AMOUNTS OUTSTANDING AS OF DEC. 31, 1965 AND SERVICE PAYMENTS, 1965, FOR 36 COUNTRIES

(millions of dollars)

Based on data reported for:		Amount Outstanding (including undisbursed)			Service payments - 1965		
		(1)	(2)	(3)	(4)	(5)	(6)
		Total	Suppliers' credits	(2) as % of (1)	Total	Suppliers' credits	(5) as % of (4)
12/65	Argentina	2,100.3	592.9	28.2	312.5	69.9	22.3
6/65	Brazil	2,719.6	811.8	29.8	505.3	318.6	63.1
12/64	Ceylon	114.1	1.4	1.2	10.0	.3	3.0
12/64	Chile	1,035.6	111.2	10.7	128.7	32.4	25.1
12/65	China (Taiwan)	289.7	30.3	10.4	9.7	7.6	78.3
6/65	Colombia	904.5	108.2	12.0	104.3	12.8	12.2
6/65	Costa Rica	124.9	0.9	0.7	22.1	0.9	4.0
12/64	Dominican Rep.	132.2	9.5	7.2	25.3	1.0	3.9
6/65	Ecuador	161.5	14.4	8.9	13.2	5.8	43.9
6/65	Ethiopia	126.0	13.5	10.7	11.9	2.6	21.8
12/64	Greece	406.8	7.5	1.8	34.7	7.8	22.5
12/65	Honduras	60.2	4.0	6.6	2.8	0.5	17.8
3/65	Iran	611.4	42.3	6.9	69.0	15.9	23.0
12/64	Israel	902.1	49.1	5.4	106.1	15.1	14.2
6/65	Korea	305.9	119.9	39.2	8.8	7.9	89.8
12/64	Liberia	173.2	41.9	24.2	11.5	6.9	60.0
6/65	Malagasy Rep.	67.5	.4	.6	3.0	.1	3.3
12/65	Mexico	2,053.9	286.2	13.9	452.9	90.0	19.9
6/65	Nicaragua	61.5	3.4	5.5	7.1	0.4	5.6
12/65	Nigeria	603.9	122.1	20.2	28.5	15.2	53.3
12/65	Pakistan	2,069.3	78.6	3.8	70.3	6.7	9.5
12/65	Paraguay	61.4	6.3	10.2	4.0	1.0	25.0
12/64	Peru	529.8	173.8	32.8	72.5	38.0	52.4
12/65	Philippines	441.4	28.2	6.4	68.7	7.6	11.1
12/65	Spain	414.5	47.1	11.4	40.4	10.5	26.0
12/65	Sudan	237.0	20.1	8.5	13.7	3.9	28.5
12/65	Swaziland	41.4	11.4	27.5	4.8	.8	16.7
12/65	Tanzania	154.3	2.3	1.5	5.7	1.6	28.1
12/65	Thailand	340.1	63.8	18.7	25.0	9.1	36.4
12/65	Trinidad & Tobago	77.5	5.7	7.4	9.3	2.8	30.1
12/64	Tunisia	195.9	4.1	2.1	12.0	3.3	27.5
12/64	Turkey	1,214.7	42.2	3.5	89.0	21.5	24.2
12/64	United Arab Rep.	1,366.5	201.6	14.8	136.7	32.5	23.8
6/65	Uruguay	274.4	25.9	9.4	22.6	1.0	4.4
12/65	Venezuela	418.4	15.9	3.8	37.3	5.3	14.2
6/65	Yugoslavia	1,352.9	472.7	34.9	202.1	98.6	18.8
	TOTAL (36 countries)	22,144.3	3,570.6	16.1	2,681.5	855.9	31.9

a/ i.e., debt of governments and government agencies of debtor countries, and debt guaranteed by them.

Source: Statistics Division,
Economics Department, World Bank

Table 3

EXTERNAL MEDIUM AND LONG-TERM PUBLIC AND PUBLICLY GUARANTEED DEBT,a/ TOTAL AND SUPPLIERS' CREDITS, SERVICE PAYMENTS (1965) IN RELATION TO COMMODITY EXPORTS (1965), FOR 36 COUNTRIES

(values in millions of dollars)

		Service Payments		Service Payments as % of Commodity Exports	
	Commodity Exports	Total Debt	Suppliers' Credits	Total Debt	Suppliers' Credits
Argentina	1,493	312.5	69.9	20.9	4.7
Brazil	1,595	505.3	318.6	31.7	20.0
Ceylon	409	10.0	0.3	2.4	0.1
Chile	682	128.7	32.4	18.9	4.8
China (Taiwan)	450	9.7	7.6	2.2	1.7
Colombia	539	104.3	12.8	19.4	2.4
Costa Rica	112	22.1	0.9	19.7	0.8
Dominican Republic	123	25.3	1.0	20.6	0.8
Ecuador	148 *	13.2	5.8	8.9	3.9
Ethiopia	116	11.9	2.6	10.3	2.2
Greece	328	34.7	7.8	10.6	2.4
Honduras	129	2.8	0.5	2.2	0.4
Iran	1,303	69.0	15.9	5.3	1.2
Israel	429	106.1	15.1	24.7	3.5
Korea	175	8.8	7.9	5.0	4.5
Liberia	143 *	11.5	6.9	6.0	4.8
Malagasy Republic	92	3.0	0.1	3.3	0.1
Mexico	1,146	452.9	90.0	39.5	7.9
Nicaragua	144	7.1	0.4	4.9	0.3
Nigeria	752	28.5	15.2	3.8	2.0
Pakistan	528	70.3	6.7	13.3	1.3
Paraguay	57	4.0	1.0	7.0	2.0
Peru	669	72.5	38.0	10.8	5.7
Philippines	767	68.7	7.6	9.0	1.0
Spain	945	40.0	10.5	4.2	1.1
Sudan	195	13.7	3.9	7.0	2.0
Swaziland	32 *	4.8	0.8	15.0	2.5
Tanzania	176	5.7	1.6	3.2	0.9
Thailand	624	22.0	9.1	3.5	1.5
Trinidad & Tobago	401	9.3	2.8	2.3	0.7
Tunisia	120	12.0	3.3	10.0	2.8
Turkey	459	89.0	21.5	19.4	4.7
United Arab Rep.	605	136.7	32.5	22.6	5.4
Uruguay	191	22.6	1.0	11.8	0.5
Venezuela	2,783	37.3	5.3	1.3	0.2
Yugoslavia	1,092	202.1	98.6	18.5	9.0
Total (36 Countries)	19,952	2,681.5	855.9	13.4	4.3

* 1964.

a/ i.e., debt of governments and government agencies of debtor countries, and debt guaranteed by them.

Table 4

EXTERNAL MEDIUM- AND LONG-TERM PUBLIC AND PUBLICLY GUARANTEED DEBT, a/
TOTAL AND SUPPLIERS' CREDITS: ESTIMATED SERVICE PAYMENTS 1966-69
IN RELATION TO AMOUNT OUTSTANDING AS OF END OF 1965, FOR 36 COUNTRIES

(millions of dollars)

	Total debt	Suppliers' credits
Service payments		
1966	2,861.1	815.5
1967	2,496.5	719.2
1968	2,339.7	581.2
1969	2,178.3	471.0
Total 1966-69	9,875.6	2,586.9
Outstanding amounts (including undisbursed) as of December 31, 1965	22,144.3	3,570.6
Service Payments as % of Outstanding amounts end of 1965		
1966	12.9	22.8
1967	11.3	20.1
1968	10.6	16.3
1969	9.8	13.2
Total 1966-69	44.6	72.4

a/ i.e., debt of governments and government agencies of debtor countries, and debt guaranteed by them.

Source: Statistics Division, Economics Department, World Bank

Mr. Robert S. McNamara September 15 1969

Irving S. Friedman

U.S. Balance of Payments Position

You may have noted that the available U.S. statistics show a marked deterioration in the U.S. balance of payments in the second quarter as compared with the first quarter of this year, as well as in the first half as compared with the corresponding period of last year. This worsening took place despite an increase in exports by some more than $2 billion, essentially because it was offset by a corresponding increase in exports accompanied by a reversal in the flow of private capital, particularly in securities transactions and banking loans. The major shift in securities transactions was, of course, primarily due to the changes in the stock market conditions. Conversely there was a sharp increase in the purchase of foreign securities by U.S. residents, in this case probably partly stimulated by the reduction in the U.S. equalization tax from 18.5% to 11%, as well as the weakness of the U.S. stock market. On the other hand, the statistics also reveal large borrowings by foreigners in the U.S. to repay Euro-dollar loans.

A seeming paradox is that in the same period the external monetary position of the U.S. improved, including an increase of over $300 million in gold holdings, as well as a large improvement in the U.S. gold tranche in the IMF reflecting dollar drawings by other members. When U.S. banks borrow Euro-dollars from their overseas branches, this tends to reduce the official holdings by central banks abroad of U.S. dollars. Indeed it may in the end result in the need for central banks abroad to sell some of their gold holdings to the U.S. to obtain the necessary dollars with which to finance these borrowings of Euro-dollars.

The statistics are, of course, available in great detail, but perhaps the most important points to emphasize are the extent to which the U.S. seems to be getting into a position of <u>no</u> surplus on its trade or current account, leaving its over-all balance of payments position to be determined nearly entirely by its capital account. There could be much argument as to whether this trend is the result of some structural change in the U.S. balance of payments or the result of inflationary trends or special temporary factors. For the Bank/IDA, however, it may well have the implications that the present U.S. Administration, which ideologically started out against balance of payments restraints, might be persuaded by the views which are still held by many in the permanent civil service that such restraints cannot be substantially relaxed in light of the balance of payments statistics. For IDA it might well be that we will have to come up with a balance of payments safeguard proposal despite the opposition from various countries to such safeguards and despite our own preference for the elimination of such safeguards in the IDA replenishment. This possibility is recognized in the IDA background paper, and I'm sure more thought will be given to what kind of safeguards might be more generally acceptable to the Part I countries if the U.S. insists on some safeguards as a precondition for its contribution to IDA.

cc: Sir Denis Rickett

FORM No. 57

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

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: September 10 1969

FROM: Irving S. Friedman

SUBJECT: Trade and Development Board: Supplementary Finance

Attached is a letter which just came in from Mr. Sarma which I believe you will find of interest.

I find it gratifying that there is this reported widespread support at the IDB Meeting that there ought eventually to be a scheme within the framework of the World Bank for supplementary financing, although, of course, it is impossible to be certain of the outcome of the TDB Meeting until it is concluded this week. It is well understood by all that resources for supplementary finance are to be additional to those for basic development financing and therefore need not be part of the Third Replenishment exercise.

I believe that the emphasis placed in some of these comments on a so-called "discretionary" scheme as against an "automatic" scheme is an over-emphasis. Our scheme was never intended to be automatic. It was designed to be discretionary in that no country would be entitled to access to supplementary financing unless its over-all development programs and policies had been agreed with the World Bank Group. We would have a mechanism for keeping in touch with the country concerned so that at the time for the need of supplementary financing the implementation of assistance could be relatively rapid to avoid unnecessary and avoidable setbacks in development. Those who have argued for a so-called discretionary scheme have essentially been skeptical whether we would be able to get such understandings or be sufficiently in touch with countries concerned that at the time of need for supplementary financing we could feel assured that their development programs and policies were worthy of support (or were not). Therefore, they have argued that a more comprehensive and time-consuming review would, in their opinion, be necessary at the time when a country requested assistance under supplementary finance. The whole tenor of our Bank work, including the measures being taken to schedule missions on a longer-term basis and the broadening of our economic reports give reason to believe that, at least for a large majority of countries, the Bank would be in a position to know at the time of an export shortfall whether the country should be given assistance under any supplementary financing policy.

Of course, there will be a need for additional work to modify our original proposals to take into account the views expressed by governments during the last four years of discussions and also the evolution of our own thinking as we have gained experience, if there is a decision taken by the Trade and Development Board to refer the matter to the World Bank to work out some scheme run by the Bank in consultation with the International Monetary Fund as recommended by the Intergovernmental Group on Supplementary Financing. This has been the outcome that some of us have anticipated from the very beginning of the submission of our staff proposals in 1965. These necessary Bank discussions, if they are requested, will mean that any negotiations for supplementary finance will come after the Third IDA replenishment and give ample opportunity to stress the point of additionality.

I am attaching for handy reference a memorandum from Mr. Kamarck of Sept. 3 which was distributed to the President's Council.

SEP 11 1969 President has seen ISF
(Returned) 4.05 p.m.

Att:

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
Cable Address—INTBAFRAD

INTERNATIONAL DEVELOPMENT ASSOCIATION
Cable Address—INDEVAS

1818 H Street, N.W., Washington, D. C. 20433, U.S.A.
Area Code 202 • Telephone - EXecutive 3-6360

Geneva, 3 September 1969

SEP 9 1969

Dear Mr. Friedman,

I enclose a summary record of the observations made by government representatives on supplementary financing in their general statements at plenary sessions on August 27 to 1 Septem

I gather that a few countries like Brazil on the LDC side and Australia in the "B" group continue to have some reservations regarding the course of action to be adopted by TDB. These are likely to be sorted out in the next couple of days, and it is expected that a request will be forwarded to the Bank Group on the lines indicated in my earlier letter to you.

Kind regards.

Sincerely,

N. A. Sarma

N. A. Sarma

Mr. Irving S. Friedman,
The Economic Adviser to the President,
International Bank for Reconstruction
and Development,
1818 H Street NW,
Washington DC 20433.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
Cable Address - INTBAFRAD

INTERNATIONAL DEVELOPMENT ASSOCIATION
Cable Address - INDEVAS

1818 H Street, N.W., Washington, D. C. 20433, U.S.A.
Area Code 202 • Telephone - EXecutive 3-6360

Geneva, 3 September 1969

Trade and Development Board, Ninth Session
Geneva, August/September 1969

Observations made by Government Representatives on Supplementary Financing in their General Statements at Plenary Sessions on August 27 to September 2, 1969

In his statement to the Board, the Secretary-General of UNCTAD himself drew attention to the Intergovernmental Group report on supplementary finance. He thought it would seem appropriate that the conclusions of the Group might be transmitted to the World Bank, inviting it to consider the adoption of measures within the framework of the principles that were agreed upon by the Group.

Brazil

The discretionary scheme now proposed by the IGG does not meet the objectives of the UNCTAD resolutions on supplementary finance.

Uganda (spokesman for the Group of 77)

We would appreciate the early and practical implementation of a discretionary scheme. No further studies are needed.

Australia

We note with interest the views expressed by the Secretary-General on the subject. It would be useful now to remit this matter to the Bank for its consideration.

Yugoslavia

We regret that it was not possible to reach an agreement in the IGG on the basis of the Bank staff scheme. We appreciate the work of the IGG and we propose that further steps be taken now to implement a scheme of supplementary finance by referring it to the World Bank at this session.

Indonesia

A scheme of supplementary finance should be put into operation with little delay.

Chile

We are prepared to accept the IGG conclusions as providing the basis for working out a supplementary finance scheme. We would like to know at this stage what degree of support the developed countries are prepared to extend to a discretionary scheme as proposed in the IGG report. If their position is not clarified at this session of the Board, we, like several other LDCs, would have to go back to a more automatic scheme.

Philippines

We endorse the suggestions of the Secretary-General with respect to supplementary finance.

Switzerland

Our interest in supplementary finance has been a continuing one. We take note of the IGG report and would support any procedures which would give a concrete shape to this new initiative in the field of international development finance.

New Zealand

We note the report of the IGG. We do not oppose a scheme of supplementary finance, but its implementation should not divert attention from commodity agreements.

Denmark (on behalf of all Nordic countries)

We have always considered supplementary finance a useful way of assisting countries to protect their development programmes against export shortfalls. The emphasis placed by the Secretary-General on this matter is appropriate. Following the report of the IGG, the momentum should be maintained and steps should now be taken to work out a scheme of supplementary finance.

United Kingdom

The United Kingdom Government is pleased at the agreement reached in the Intergovernmental Group.

Netherlands

It is the view of the Netherlands Government that the agreement reached in the Intergovernmental Group on supplementary finance is most welcome. It should now be transmitted to the World Bank Group for implementation.

Canada (the remarks of the Canadian Representative were confined to two specific topics: Preferences and Supplementary Finance)

We are gratified at the report of the IGG and the results that were achieved in IGG. There was enough support for supplementary finance from both developed and developing countries. In our view, a discretionary scheme on the lines suggested in the IGG report can safeguard the development programmes of countries. There is merit in integrating supplementary finance facility into an expanded IDA. Accordingly, the implementation of supplementary finance cannot be independent of IDA replenishment. In our view, it is now appropriate to invite the World Bank to prepare a scheme on the lines recommended in the IGG report.

Guatemala

Supplementary finance is absolutely essential for the LDCs, but we doubt whether the developed countries have the will to provide the necessary resources for it. We would prefer to revert to the original proposal of the Bank staff.

United States of America

The Board would be asked to act on the IGG report. It was an achievement for the Intergovernmental Group to obtain a consensus in this complicated matter.

Mexico

A scheme of supplementary finance should be implemented right from the beginning of the second development decade.

Venezuela

We trust that it would be possible, with the assistance of the developed countries, to evolve a discretionary scheme which would implement the objectives of UNCTAD resolutions on supplementary finance.

India

We support the proposal to invite the World Bank to implement a scheme of supplementary finance, but, in our view, the resources for supplementary finance must be additional.

United Arab Republic

The report of the Intergovernmental Group on supplementary finance is a step forward and we urge IBRD to put this scheme into effect at an early date.

Form No. 57

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

Mr. Friedman

SEP 4 1969
9.15 a.m.

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: September 3, 1969

FROM: Andrew M. Kamarck amk

SUBJECT: Trade and Development Board Meeting: Supplementary Financing

Mr. Sarma, the Bank Observer at the TDB Meeting, reports that in his statement before the Board on August 27 the Secretary-General of UNCTAD said the following on supplementary financing:-

"I have particular pleasure in informing the Board that, at its final session, the Intergovernmental Group on Supplementary Financing reached some bases of agreement. Already at the first session of UNCTAD the question had been raised whether it would be possible to work out a long-term system of financial assistance for the developing countries to help them to prevent the disruption of their development programmes resulting from export shortfalls or from causes beyond their control. This question has now been answered and it has been agreed that arrangements for supplementary financing can be made for this purpose.

"It was also agreed that this supplementary financing should be administered by the World Bank, in consultation with the International Monetary Fund. The execution of these financial measures should leave the operating agency a certain margin of discretion. It is hoped, however, that certain appropriate objective criteria will be developed to ensure that a country's development plans and programmes will be adequately protected from the effects of export shortfalls.

"It was also recognized that there would be no sense in merely diverting resources from basic development financing for purposes of supplementary financing. I take this position of the Group to mean that the resources for supplementary financing are to be additional to those already envisaged for basic financing.

"The Board will have to decide on the most practical procedures for applying the principles agreed to by the Intergovernmental Group. It would seem appropriate that at this stage the results achieved by the Group might be transmitted to the World Bank inviting it to consider the adoption of measures within the framework of the principles that were agreed. I would hope that the Bank might be in a position to do this expeditiously so that this question could be considered in connection with the next replenishment of IDA.

"The arrangement with the World Bank might provide that, after a reasonable period, the Bank would inform us of the results of its efforts to devise machinery for the agreements reached by the Group. I am confident that an arrangement of that kind would be acceptable to the Bank."

Mr. Sarma reports, as regards the concluding paragraph, that he has been definitely given to understand that the Secretary-General had no time limit or target date in mind, but only some kind of progress report in due course.

cc: President's Council

FORM NO. 58 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: September 10, 1969

FROM: Irving S. Friedman

SUBJECT: Attached Memorandum on Distribution of Country Program Papers

For your information.

In addition to the people listed in Mr. Kamrck's memorandum, I am proposing to add Mr. William Clark in his capacity as Director of the Public Affairs and Information Department. Mr. Clark has requested that he be continued on the distribution list.

ISF

FORM No. 57 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Acting Secretary, Economic Committee **DATE:** September 10, 1969

FROM: A. M. Kamarck, Deputy Chairman, Economic Committee

SUBJECT: Distribution of Country Program Papers

This is to confirm our telephone conversation on the above subject.

Beginning immediately, the Economic Committee Secretariat will limit the distribution of Country Program Papers (and any lone straggler of the Country Economic Policy Papers and minutes of the meetings on them) to the members of the Economic Committee, their alternates, those specifically invited to the meeting on a C.P.P., and Messrs. McNamara, Knapp, Cope, Adler, Chadenet and Baum. Any distribution to anyone else is to be decided on a case by case basis.

You might wish to notify the members of the Committee of this decision.

Cleared with and cc: Mr. Friedman

cc: Messrs. Knapp/Cope
Ripman/Twining
Adler

AMK/vhw

President has seen

SEP 1 8 1969

(Returned)

FORM No. 89
(2.66)

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT
ASSOCIATION

INTERNATIONAL FINANCE
CORPORATION

ROUTING SLIP	Date August 4, 1969

OFFICE OF THE PRESIDENT

Name	Room No.
~~Mr. Kamarck~~ ame	D.527
Mr Friedman	

	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

I thought you might be interested in the attached.

Copy sent to Mr. Knapp 8/6

From Irving S. Friedman

FORM NO. 57 INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: August 1 1969

FROM: Irving S. Friedman

Returned (Mr. ...)
AUG 4 1969

SUBJECT: Exception to the rule

I promised not to get involved in Bank business but Graydon Upton asked me whether the matter contained in the attached letter had been brought to your attention.

It is something he and I had discussed most informally some time ago but the letter came in the day I was taken ill. I told him I would send on the letter to you so that you would be made aware of this matter.

Att:

President has seen

INTER-AMERICAN DEVELOPMENT BANK
WASHINGTON, D. C. 20577

EXECUTIVE
VICE PRESIDENT

CABLE ADDRESS
INTAMBANC

June 26, 1969

Mr. Irving Friedman
Economic Adviser to the President
International Bank for Reconstruction
and Development
1818 H Street, N.W.
Washington, D.C. 20433

JUN 30 1969
2 [illegible]

Dear Irving:

This summer we have assigned one of our young men to make a review of the Bank's responsibility for and participation in, activities of the District of Columbia with reference to the underprivileged, the riot destroyed areas, and other community problems.

As a large employer of personnel, many of whom live in the District, and are affected by conditions in the District, it seems appropriate that we make a special review of this matter, in the same way that many business concerns in metropolitan areas are reviewing their responsibilities. This review will cover not only such matters as employment and contributions to community funds, but also whether there is any practical way in which the techniques developed in helping under developed areas in Latin America can be applied here in Washington and can be supported by the Bank.

It occurred to me that since the World Bank has a parallel position to our own with respect to involvement in the community, and the same type of experience in development, that you might wish also to assign an individual to make a preliminary review of this matter. At this very preliminary stage, I might say, our primary interest is on orientation and background knowledge, which could be followed if appropriate by recommendations for specific studies.

I hope you will look favorably on this idea.

Yours sincerely,

Graydon

T. Graydon Upton

INTER-AMERICAN DEVELOPMENT BANK
WASHINGTON, D.C. 20577

CABLE ADDRESS
INTAMBANC

EXECUTIVE
VICE PRESIDENT

June 26, 1969

Mr. Irving Friedman
Economic Adviser to the President
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and Development
1818 H Street, N.W.
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I hope you will look favorably on this idea.

Yours sincerely,

T. Graydon Upton

1969 JUN 28 PM 1:41

GENERAL FILES
RECEIVED

FORM No. 57

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

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: July 1, 1969

FROM: A. Broches

JUL 2 1969

12 noon

SUBJECT: Reported decisions of Switzerland with respect to joining international organizations

I inquired at the Embassy about the background of the report which was mentioned in our meeting yesterday morning.

The Swiss Government has for some considerable time had under study the question of joining the United Nations (much desired by the Socialists) and of the Bretton Woods institutions, among others. From time to time two members of Parliament from Zurich have addressed questions on this point to the Government. Yesterday's press conference was in part in response to these questions and in part an announcement of the completion of the Government's study. The story in this morning's New York Times appears to be substantially correct.

The Swiss Embassy has cabled Berne for a copy of the report for our use. They expect it to come in with the courier arriving Friday so that we should have it by the beginning of next week.

P.S. My spokesman at the Embassy said that in their judgment it would take between three and four years for Switzerland to join the Bretton Woods institutions.

cc: President's Council

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT
WASHINGTON, D.C. 20433, U.S.A.

OFFICE OF THE PRESIDENT

U Thant
The Secretary-General
United Nations
New York, New York 10017

Dear Mr. Secretary-General:

I welcome the proposal in your letter of April 28 that the World Bank become more closely associated with the development of the Mekong Basin, and I agree that it would be desirable to work out mutually satisfactory arrangements which would enable the Bank to support the United Nations and the Mekong Committee in formulating an overall plan for the development of the Basin, in determining investment priorities under that plan which reflect the development needs of the riparian states, and in making arrangements for the financing and execution of high priority projects.

I feel--and I am sure you agree--that the Asian Development Bank should also play an important role in the development of the Mekong Basin. If the World Bank is to become involved in this matter, it would expect to work closely with the Asian Development Bank as well as with the United Nations and the Mekong Committee.

You ask for my view as to how we should proceed. As I see it, the first step is for the Bank to become more fully informed on the work already done by the Mekong Committee. I am organizing a special unit in the Bank to start on this at once, and I shall designate an individual to serve as the Bank's Special Representative for Mekong Basin affairs. When our studies have advanced sufficiently to enable us to discuss a specific plan of action for Bank participation, we will be in touch with you or your representatives, the Mekong Committee and the Asian Development Bank.

For your information, I have discussed the Bank's possible involvement in Mekong Basin affairs with the President of the Asian Development Bank and with a number of our member countries that have been supporting the efforts of the Mekong Committee. I am glad to say they all agreed that the Bank should give an affirmative response to your proposal.

Sincerely,

Robert S. McNamara

Robert S. McNamara

APR 30 REC'D

THE SECRETARY-GENERAL

28 April 1969

Dear Mr. McNamara,

As you know, for many years the United Nations has actively supported the cooperative endeavors of the governments of Cambodia, Laos, Thailand and the Republic of Viet-Nam to develop the resources of the Lower Mekong Basin for the benefit of all the people of the riparian states. Under the aegis of the Economic Commission for Asia and the Far East, the four governments, in 1957, formed the Committee for Coordination of Investigations of the Lower Mekong Basin. The Committee has continued to function actively despite the trying period through which the region has been passing, and is widely regarded as an outstanding example of international cooperation for economic development.

The Mekong Committee has built up a small professional staff, as well as continuing to draw on the staff resources of ECAFE; has produced a series of studies that provide a useful foundation for future planning; and has brought to the stage of realization, under its sponsorship, several important projects on the tributaries of the Mekong.

The Bank, of course, is well informed as to the progress to date of the various aspects of this work so I need not go into detail. I do feel that it is important to note that to date 25 governments, in addition to the riparian states, have demonstrated their support for the broad objectives the four governments are seeking to obtain through the Committee, by contributing in some form to the implementation of projects in the Basin. Most of those governments are members of the World Bank.

While there is much that can still be done by the Committee, and its supporting organizations, working along present lines, it

.../2

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

seems to me that the cooperative effort for the development of the Mekong Basin is entering a new and critical phase in which it would be in the interests of the governments which are members of the Committee, the other governments that have supported projects in the Basin, and the world community generally, that the World Bank should become more closely associated with the whole effort for the development of the Mekong Basin. Decisions about main stream projects which would require the commitment of very large resources will soon need to be made. It seems to me that it would be in the interest of all concerned that these decisions should be made, so far as possible, in the context of a careful review of investment priorities for the Basin as a whole and for the general development programmes of the riparian states with reference, inter alia, to the amplified basin plan which the Committee and its Advisory Board expect soon to be studying. Analyses of the economic and technical aspects of alternative uses for the water and other resources of the Basin will need to be carried out.

At a period perhaps no longer very far in the future, it will be necessary to mobilize substantial amounts of international capital to help finance some of these large main stream projects and other projects in or closely related to Basin development. Such large projects will present problems of implementation and management to the solution of which competent external assistance could make a very important contribution.

These are all matters in which the Bank has wide experience and in which I believe your collaboration with the United Nations and the Mekong Committee would be most valuable. I would appreciate it if, when you have had time to consider this letter, you would let me know whether, in principle, you would be prepared to support our efforts and those of the Mekong Committee along the lines which I have suggested, and perhaps in other ways, and, if so, how you would propose to proceed.

For your information, I have consulted the Members of the Mekong Committee concerning this approach to you and they have encouraged me to seek your cooperation.

Yours sincerely,

U Thant

U Thant
Secretary-General