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U.S. Balance of Payments
and Economic Development

Address by Mr. Irving S. Friedman, The Economic Adviser to the President, World Bank, to the Conference for Corporation Executives, School of Advanced International Studies, the Johns Hopkins University

April 28, 1967

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Mr. Chairman, Ladies and Gentlemen:

In the time allotted to me this afternoon I would like to concentrate on what part do the less developed countries - the so-called LDC's - play in creating the existing deficit in the United States balance of payments: what impact have they had on the gold question and the effects on the LDC's and the U.S. of the U.S. balance of payments measures? I will try to deal with facts and figures rather than philosophy. I would like to emphasize from the outset that I will be dealing with aggregate figures, of which the most important is treating the LDC's as a group. There are of course great differences among these countries, for example the oil producing countries, and this qualifies any generalization which I will make. However, it would be more than cumbersome to separate in these brief comments the LDC's in terms of individual countries or to make other groupings, while treating them as a single group has the merit of being able to focus our attention on certain key aspects of the relation between the U.S. balance of payments and economic development. Needless to say, much of what I will say applies also to the relation of other industrial countries with the LDC's - but I am concentrating on the U.S. because the subject of our conference is the U.S. balance of payments.

The first point I would like to make is that despite all the talk of how much resources are transferred to the LDC's the flow of traffic in resources between the developed and the less developed countries has not been one way. The net transfer of resources to the less developed countries

has been much less than the figure of $9 to $9.5 billion that we keep on hearing as representing the level of official and private resource flows to the developing countries. We estimate that the developed countries in 1966 got back about $5 billion in investment income payments, in profits, dividends and interest. This means that the additional net payments flow to less developed countries from advanced countries has been of the order of $4.5 billion per year rather than $9 or $9.5 billion; this at a time when the combined gross domestic product of the developed countries is now close to $1,500 billion per year.

For the U.S., the flow of official capital to the less developed countries in the form of grants and loans - net of amortization - in 1966 was $3.5 billion and the flow of private capital net of repatriation was $700 million - the total of private and official flows being $4.2 billion. As against this, in 1966 the U.S. received about $3.1 billion from LDC's including the oil producing countries, in the form of investment income. If we take this sum out of the figure of $4.2 billion we get a figure of $1.1 billion for the net payments flow from the U.S. to the LDC's, even excluding LDC's direct investments in the U.S. If the same exercise is done for other industrial countries we find that it amounts to about $3 billion. A strict comparison is dangerous to make because of the probable inadequacy of the statistics, particularly with respect to private capital flows. It is clear that when considering official capital flows the U.S. is by far the largest single contributor. However, when considering the contribution of the U.S. economy to the less developed world, it is important to keep in mind not only what is happening in the official aid field but also what is happening in the private sector.

A closer look at the U.S. balance of payments for 1966 reveals a number of interesting points. Firstly, the U.S. tends to have a trade surplus with the less developed world of about $1.5 billion a year. (We don't know of course what the picture would be like without the effects of the U.S. AID program, but undoubtedly it would be less.) In addition, the U.S. has a net surplus of income payments on investments in less developed countries including oil producing countries, of about $3 billion. All other invisibles - tourism, insurance, etc. - show in aggregate a U.S. deficit of about $1 billion, but mainly because of the need for U.S. military expenditures in foreign currencies. The total balance of goods and services with the LDC's thus adds up to a U.S. surplus of $3.5 billion. Against this surplus, the U.S. has a deficit on capital account with the less developed countries. Most of this deficit reflects the U.S. AID program of about $3.8 billion, but nearly all of this was merely the counterpart to the outflow of U.S. goods and services.

At the final count, there is the figure of the balance of payments deficit as estimated by the conventional liquidity method. In 1966 the U.S. had an over-all deficit of about $400 million with LDC's - about half the size of deficit in each of the three previous years. You will all recall that the total balance of payments deficit in 1966 was $1.4 billion. The less developed countries thus caused less than a third of the over-all deficit.

To those of you who are concerned with the drain on gold, I can assure you that the developing countries as a group have not directly cashed in any foreign exchange for gold in recent years. Moreover, the LDC's,

taken together, have recently had surpluses with other industrial countries as well as the U.S.; thus they are not adding directly to the dollar accumulation and consequent gold conversion demand of industrial countries other than the U.S. It may be worth mentioning that U.S. figures do show a purchase of $93 million worth of gold by LDC's in 1966. These purchases must, however, be seen in context of the general increase in IMF quotas, by which LDC's transferred to the Fund gold worth $219 million. The effects of these transactions on the U.S. gold stock have been offset by a special gold deposit which the Fund made with the U.S. The rest of the gold transfer by LDC's to the IMF was made possible by a reduction in the net gold holdings of the LDC's as a group.

Thus, it may be concluded that the U.S. trade and financial relations with LDC's, leaving aside of course the effects of the Viet-Nam hostilities, has not been a major cause of the U.S. balance of payments deficit.

The extent and persistency of the U.S. balance of payments deficit have led to the adoption of government policies designed to reduce, if not eliminate this deficit. The heaviest effects have been on public rather than private flows of credit. In fact the U.S. voluntary balance of payments program does not appear to have greatly influenced the outflow of private capital to the less developed countries. This is largely the result of conscious intent. Specific exceptions have been made in all parts of the voluntary balance of payments program. In the part which applies to corporations, under the guidance of the Department of Commerce, investment in these countries is speicifically exempt. In the parts which apply to banks and non-bank financial institutions, under the guidance of the Federal Reserve Board, these institutions are asked to give first priority to export credits and second priority to loans to less developed countries within the over-all ceilings of foreign credit. The absence of any ceiling for credits and

investments held by non-bank financial institutions with a maturity exceeding ten years is also helpful for the flow of credit through such agencies as the IBRD. Finally, less developed countries are also exempt from the interest equalization tax, as are international development institutions, as well as companies operating primarily in those countries. Thus insulated, the actual flow of private investment to LDC's appears to have been influenced by larger factors which hide any readily discernible effects of the U.S. balance of payments program of the last three years. The total flow rose from $1.3 billion in 1964 to $1.9 billion in 1965, but fell to $1 billion in 1966. The greatest part of these changes appears to be attributable to changes in investment in petroleum. The voluntary balance of payments program, insofar as it applies to banks and non-bank financial institutions, has seemingly not acted as a limit because banks have not even increased their credit outstanding to the LDC's up to the suggested ceilings. Rather it was the general credit squeeze which appears to have done more than anything else to restrain the outflow. I will not try to go into the indirect effects on the LDC's of limiting U.S. investments in other developed countries.

Thus the most important balance of payments measure for the LDC's is tying U.S. AID to U.S. procurement. Until recent years, the U.S. had been by far the largest source of untied assistance, since European countries and Japan have traditionally given much of their assistance in tied forms. In addition to the Export-Import Bank loans and PL.480 commodity loans, U.S. tying policy now covers 85% of the AID program and

the percentage of tied aid continues to rise. However, the essential elements are to reduce to a small amount the use of U.S. aid funds for procurement outside of the U.S., and to try to avoid the use of aid funds for goods and services that would in any case be purchased for cash on a commercial basis.

The most familiar effect of tying is the higher prices the developing countries have often to pay for their imports under tied aid programs. This is no minor matter as seen by our own experience in the Bank. A study of the experience of Pakistan shows that in an item-by-item comparison of the lowest quotation from the tied source with the lowest quotation in the international competitive bidding in a sample of twenty development projects financed by six countries, the weighted average price came out to be 51% higher than the international bids. A comparison of commodities procured from the U.S. under non-project assistance, shows that U.S. prices were 40-50% higher than international prices for most iron and steel products. Other instances are not lacking when price quotations have been substantially higher - when the suppliers knew that the credit was tied than when bargaining was on an untied basis. This situation does not, of course, apply only to the U.S., but applies also to suppliers in other countries.

Taken all in all, estimates made indicate that the tying results in about 15% increase in prices of commodities financed by bilateral aid programs of the various industrial countries. This means that the current level of official assistance which has been running at the rate of about \$6.5 billion a year could have been used, had international competitive bidding been possible, to finance additional imports of \$1 billion by the developing countries.

The impact of tied aid is, of course, not felt equally by all developing countries. Dependence on tied aid varies a great deal as between areas, and it is interesting to note that the countries of Asia and Africa as a group rely relatively more on tied aid to finance their imports than do developing countries of Southern Europe, Western Hemisphere and the Middle East. Using 1961 through 1964 figures for bilateral aid most of which is tied, and guaranteed credits which are all tied, the following is the regional picture of the significance of tying in the total imports of the LDC's; for Africa it was 30%, for Asia 26%, for Southern Europe 11%, for Western Hemisphere 10% and for the Middle East 7%. The countries which faced the worst situation in this respect were Korea 48.9%, Pakistan 41%, Bolivia 29.2%, India 28.8%, Turkey 28.4% and Tunisia 26.0%.

Countries which rely heavily on tied aid confront an odd situation. Their means of paying for imports is a mixed batch of moneys - some freely usable anywhere for any purpose, but much consists of parcels of moneys which can be used only in certain countries and for certain commodities or services. Imagine a balance sheet in which the income account consisted of such a jumble of miscellaneous money! It was this kind of situation which helped convince the European countries in the 1950's that their currencies had to become convertible, i.e., freely usable everywhere. Despite this mixture of limited means of payment the LDC's have to pay back amortization and interest on their loans or dividends or repatriation of capital in convertible foreign currencies. Moreover, much of their imports, for example oil and copper imports, can only be obtained for free foreign exchange.

When the terms of tied loans are generous, the payments difficulties of the LDC's are at least mitigated by the subsidy to the developing countries inherent in low rates of interest and long repayment periods. However, not only has there been a shift towards more tied loans, but also in certain countries, including the U.S., the terms of loans have been getting slightly harder.

Recently we in the World Bank did a study on the problem of suppliers' credits to the developing countries. We were rather struck by the relatively easy availability for developing countries of this form of finance which was not only tied but was excessively costly in interest charges and other ways and provided for only short repayment periods. The problems created by the excessive use of suppliers' credits by such countries as Brazil, Ghana and Indonesia are well-known, creating severe difficulties for both creditors and borrowers.

A number of debt problems that we see around the world today have, in my view, been significantly enhanced by the shift toward more tied credits. Thus, even when amortization and interest payments due on previous loans have been offset by an increase in gross flows of aid, the problem of meeting debt obligations by the developing country has remained, because as just said debt service payments must be financed from free exchange. Thus, an increase in assistance, when tied, may still leave unsolved the problem of debt service payments.

The use of tied credits by industrial countries has also made it more difficult for the LDC's to develop their export capacities. These countries cannot hope to compete in providing even tied export credits, and yet other LDC's are natural markets for their exports, particularly for their newer industries. We ran a statistical exercise on the relationship existing between availability - or non-availability - of free foreign exchange

and the pattern of imports in a selected group of 20 developing countries. We took two groups of ten countries each, the first group including countries with nearly all imports purchased with free foreign exchange; the second group including countries heavily dependent on tied aid for financing their imports. We found that in this sample, those with free use of foreign exchange imported a significantly larger share from the LDC's than countries using much more tied funds. We are all eager to increase the export earnings of the LDC's if for no other reason than to achieve a reduction in need for foreign assistance.

Another distinct disadvantage in the use of tied aid is that it interferes with the process of encouraging the LDC's to make greater use of the market mechanism. The need to use various types of tied funds interferes with progress in elimination of discrimination in controls and imports where tied funds finance a substantial portion of imports. This, in turn, interferes with the elimination of controls over internal prices and production. Thus the technique of tying tends to act as a barrier against one of the most hopeful developments in the less developed world, namely, the realization that only through greater reliance on the market mechanism can more rapid economic development be achieved.

Moreover, in many instances tied aid is giving the picture of U.S. industry as being high cost, despite the fact that U.S. industry under open competition has held its own and has been quite competitive vis-a-vis other industrial countries. Since 1959, in all major markets - common market, EFTA, Canada, Japan, LDC's - the U.S. share has increased, reflecting a maintenance and even some strengthening of the U.S. competitive position. The tying of loans has, however, had harmful effects on supplier competition since this procedure has often required the recipient country to purchase equipment from a single national producer or a small group of producers.

In a world which is becoming intensely more competitive, I am sure that we would all agree that American industry can, in the long run, hold its own abroad on the basis of efficiency.

In brief, I have tried to show that external transactions of the U.S. with the less developed countries is not a major factor in the U.S. deficit, nor have the LDC's been a drain on the U.S. gold stock. Incidentally, the positive contribution of the World Bank group to the U.S. balance of payments is about equal to the U.S. deficit with the LDC's. The U.S. has found it necessary to introduce a number of measures such as tying loans to procurement and limitations on direct investment abroad and loans by U.S. corporations. As I have said, the latter of these does not seem to have adversely affected the LDC's to a significant degree, but the former has. At the same time it has to be recognized that tying aid to procurement has certainly helped the U.S. balance of payments. In the absence of tying, the payments deficit is likely to have been considerably greater. An AID investigation suggests that the substitution of AID-financed for commercial U.S. exports is quite small in all but a few AID-receiving countries. They estimate that aid tying - AID, PL.480, and Export-Import Bank financing - may have increased U.S. commodity exports in 1965 by $1.63 billion f.o.b.

Thus, in view of the current U.S. balance of payments problem, it may well be unrealistic to suggest abandonment of tying. I would, however, like to suggest that any tying of aid for balance of payments reasons, either here in the U.S. or elsewhere, should be undertaken only after carefully weighing the disadvantages of this move to both partners in the aid relationship - and that tying be held to a minimum. Moreover, more attention should be given to bringing tying practices of countries more into line with each other, thus reducing the complexities for the borrower; the impact of tying

on the value of aid should be realistically assessed when computing the magnitudes of aid and taken into account when dealing with debt crises. Seen from an international viewpoint, in selecting commodities eligible for purchase with AID funds, it may be desirable to ensure that they are commodities produced by U.S. industries which are internationally competitive or come very close to being so, and try to avoid situations in which suppliers within the U.S. are so few as to lead to large over-pricing.

In conclusion, the balance of payments reason for tying by any country should be regarded as temporary. Countries have had other reasons for tying such as promotion of exports or to promote and strengthen a special relationship. Because of such reasons, some tying of exports may well become permanent. I hope that in the U.S. and elsewhere, the tying introduced for balance of payments reasons will not be continued after the balance of payments situation no longer requires their use. Given the widespread practice of tying by most of the industrial countries, any successful attempt to reverse the trend will probably involve some form of international understanding and cooperation by those countries.

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Mr. Chairman, Ladies and Gentlemen:

In the time allotted to me this afternoon I would like to concentrate on what part do the less developed countries - the so-called LDC's - play in creating the existing deficit in the U.S. balance of payments: what impact have they had on the gold question and the effects on the LDC's and the U.S. of the U.S. balance of payments measures. I will try to deal with facts and figures rather than philosophy.

The first point I would like to make is that despite all the talk of how much resources are transferred to the LDC's the flow of traffic in resources between the developed and the less developed countries has not been one way. The net transfer of resources to the less developed countries has been much less than the figure of $9 to $9.5 billion that we keep on hearing as representing the level of official and private resource flows to the developing countries. We estimate that the developed countries in 1966 got back about $5 billion in investment income payments, in profits, dividends and interest. This means that the additional net capital available to less

developed countries from advanced countries has been of the order of $4.5 billion per year rather than $9 or $9.5 billion; this at a time when the combined gross domestic product of the developed countries is now close to $1,500 billion per year.

For the U.S., the flow of official capital to the less developed countries in the form of grants and loans - net of amortization - in 1966 was $3.5 billion and flow of private capital net of repatriation was $700 million -- the total of private and official flows being $4.2 billion. As against this, in 1966 the U.S. received about $3.1 billion from LDC's including the oil producing countries, in the form of investment income. If we take this sum out of the figure of $4.2 billion, we get a figure of $1.1 billion for the net transfer of resources from the U.S. to the LDC's, even excluding LDC direct investments in the U.S. So when we talk about the real transfer of resources from the U.S. to the LDC's, it is important to bear in mind that it is the $1.1 billion we are talking about and not the $4.2 billion. Moreover, the U.S. provides only about one-fourth of the net flow of resources while it accounts for about one-half or more of the GDP of the developed countries.

A closer look at the U.S. balance of payments for 1966 reveals a number of interesting points. Firstly, the U.S. tends to have a trade surplus with the less developed world of about $1.5 billion a year. (We don't know of course what the picture would be like without the effects of the U.S. AID program, but presumably it would be less). In addition, the U.S. has a net surplus of income payments on investments in less developed countries of about $3 billion -- a sum in the order of magnitude of the entire AID program. All other invisibles -- tourism, insurance, etc. -- show in

aggregate a U.S. deficit of about $1 billion but mainly because of the need for U.S. military expenditures in foreign currencies. The total balance of goods and services with the LDC's thus adds up to a U.S. surplus of $3.5 billion. Against this surplus, the U.S. has a deficit on capital account with the less developed countries. Most of this deficit reflects the U.S. AID program of about $3.8 billion, but nearly all of this was merely the counterpart to the outflow of U.S. goods and services.

It may be of some interest to point out the magnitude of private capital flows to LDC's. In 1966 these amounted to less than $900 million. At the same time, there was an inflow of investments by LDC's to the U.S. of almost $600 million, mostly as long-term deposits in U.S. banks.

At the final count, one is mostly interested in the magic figure of the balance of payments deficit. In 1966 the U.S. had an over-all deficit of about $400 million with LDC's -- about half the size of deficit in each of the three previous years. You will all recall that the total balance of payments deficit in 1966 was $1.4 billion. The less developed countries thus caused less than a third of the over-all deficit.

To those of you who are concerned with the drain on gold, I can assure you that the developing countries as a group have not cashed in any foreign exchange for gold in recent years. It may be worth mentioning that U.S. figures do show a purchase of $93 million worth of gold by LDC's in 1966. These purchases must, however, be seen in context of the general increase in IMF quotas, by which LDC's transferred to the Fund gold worth $219 million. The effects of these transactions on the U.S. gold stock have been offset by a special gold deposit which the Fund made with the United States. The rest of the gold transfer by LDC's to the IMF was made possible by a

reduction in the net gold holdings of the LDC's as a group.

Thus, it may be concluded that the U.S. trade and financial relations with LDC's has not been the major cause of the U.S. balance of payments deficit. However, the extent and persistency of the U.S. balance of payments deficit have led to the adoption of government policies which are of primary importance to the LDC's. The heaviest effects have been on public rather than private flows of credit. In fact the U.S. voluntary balance of payments program does not appear to have greatly influenced the outflow of private capital to the less developed countries. This is largely the result of conscious intent. Specific exceptions have been made in all parts of the voluntary balance of payments program. In the part which applies to corporations, under the guidance of the Department of Commerce, investment in these countries is specifically exempt. In the parts which apply to banks and non-bank financial institutions, under the guidance of the Federal Reserve Board, these institutions are asked to give first priority to export credits and second priority to loans to less developed countries within the over-all ceilings of foreign credit. The absence of any ceiling for credits and investments held by non-bank financial institutions with a maturity exceeding ten years is also helpful for the flow of credit through such agencies as the IBRD. Finally, less developed countries are also exempt from the interest equalization tax, as are international development institutions, as well as companies operating primarily in those countries. Thus insulated, the actual flow of private investment to LDC's appears to have been influenced by larger factors which hide any readily discernible effects of the U.S. balance of payments program of the last three years. The total flow rose from $1.3 billion in 1964 to $1.9 billion in 1965 but fell to $1 billion in

1966. The greatest part of these changes appears to be attributable to changes in investment in petroleum. The voluntary balance of payments program, insofar as it applies to banks and non-bank financial institutions, has seemingly not acted as a limit because banks have not even increased their credit outstanding to the LDC's up to the suggested ceilings. Rather it was the general credit squeeze which appears to have done more than anything else to restrain the outflow. I will not try to go into the indirect effects on the LDC's of limiting U.S. investments in other developed countries. This may have reduced the ability of these other countries to provide capital to the LDC's but this is conjectural and I don't believe it has been a major factor thus far.

Thus the most important balance of payments measure for the LDC's is tying U.S. AID to U.S. procurement. In addition to the Export-Import Bank loans and PL. 480 commodity loans, this policy now covers 85 percent of the AID program and the percentage of tied aid continues to rise. However, the essential elements are to reduce to a small amount the use of U.S. aid funds for procurement outside of the U.S. and to try to avoid the use of aid funds for goods and services that would in any case be purchased for cash on a commercial basis.

The most familiar effect of tying is the higher prices the developing countries have often to pay for their imports under tied aid programs. This is no minor matter as seen by our own experience in the Bank. A study of the experience of Pakistan shows that in an item-by-item comparison of the lowest quotation from the tied source with the lowest quotation in the international competitive bidding in a sample of twenty development projects financed by six countries, the weighted average price came out to be 51

percent higher than the international bids. A comparison of commodities procured from the U.S. under non-project assistance, shows that U.S. prices were 40-50 percent higher than international prices for most iron and steel products. Other instances are not lacking when price quotations have been substantially higher - when the suppliers knew that the credit was tied than when bargaining was on an untied basis. This situation does not, of course, apply only to the U.S. but applies also to suppliers in other countries.

Taken all in all, estimates made indicate that the tying results in about 15 percent increase in prices of commodities financed by bilateral aid programs. This means that the current level of official assistance which has been running at the rate of about $6.5 billion a year could have been used, had international competitive bidding been possible, to finance additional imports of $1 billion by the developing countries.

The impact of tied aid is, of course, not felt equally by all developing countries. Dependence on tied aid varies a great deal as between areas, and it is interesting to note that the countries of Asia and Africa as a group rely relatively more on tied aid to finance their imports than do developing countries of Southern Europe, Western Hemisphere and the Middle East. Using 1961 through 1964 figures for bilateral aid most of which is tied, and guaranteed credits which are all tied, the following is the regional picture of the significance of tying in the total imports of the LDC's: for Africa it was 30 percent, for Asia 26 percent, for South Europe 11 percent, for Western Hemisphere 10 percent, and for the Middle East 7 percent. The countries which faced the worst situation in this respect were Korea 48.9 percent, Pakistan 41.0 percent, Bolivia 29.2 percent, India 28.8

percent, Turkey 28.4 percent, and Tunisia 26.0 percent.

Countries which rely heavily on tied aid confront an odd situation. Their means of paying for imports is a mixed batch of monies -- some freely usable anywhere for any purpose, but much consists of parcels of monies which can be used only in certain countries and for certain commodities or services. Imagine a balance sheet in which the income account consisted of such a jumble of miscellaneous monies! It was this kind of situation which helped convince the European countries in the 1950's that their currencies had to become convertible, i.e., freely usable everywhere. Despite this mixture of limited means of payment the LDC's have to pay back amortization and interest on their loans or dividends or repatriation of capital in convertible foreign currencies. Moreover, much of their imports, for example oil and copper imports, can only be obtained for free foreign exchange.

When the terms of tied loans are generous payments difficulties of the LDC's are at least mitigated by the subsidy to the developing countries inherent in low rates of interest and long repayment periods. However, not only has there been a shift towards more tied loans, but also in certain countries, including the U.S., the terms of loans have been getting harder.

Recently we in the World Bank did a study on the problem of suppliers' credits to the developing countries. We were rather struck by the relatively easy availability for developing countries of this form of finance which was not only tied but was excessively costly in interest charges and other ways and provided for only short repayment periods. The problems created by the excessive use of suppliers' credits by such countries as Brazil, Ghana and Indonesia are well known, creating severe difficulties for both creditors

and borrowers.

A number of debt problems that we see around the world today have, in my view, been significantly enhanced by the shift toward more tied credits. Thus, even when amortization and interest payments due on previous loans have been offset by an increase in gross flows of aid, the problem of meeting debt obligations by the developing country has remained, because, as just said, debt service payments must be financed from free exchange. Even an increase in assistance, when tied, may still leave unsolved the problem of debt service payments.

The use of tied credits by industrial countries has also made it more difficult for the LDC's to develop their export capacities. These countries cannot hope to compete in providing even tied export credits and yet other LDC's are natural markets for their exports, particularly for their newer industries. We ran a statistical exercise on the relationship existing between availability - or non-availability - of free foreign exchange and the pattern of imports in a selected group of 20 developing countries. We took two groups of ten countries each, the first group including countries with nearly all imports purchased with free foreign exchange; the second group including countries heavily dependent on tied air for financing their imports. We found that in this sample, those with free use of foreign exchange imported a significantly larger share from the LDC's than countries using much more tied funds. We are all eager to increase the export earnings of the LDC's if for no other reason than to achieve a reduction in need for foreign assistance.

Another distinct disadvantage in the use of tied aid is that it interferes with the process of encouraging the LDC's to make greater use of the

market mechanism. The need to use various types of tied funds interferes with progress in elimination of discrimination in controls and imports. This, in turn, interferes with the elimination of controls over internal prices and production. Thus the technique of tying tends to act as a barrier against one of the most hopeful developments in the less developed world, namely, the realization that only through greater reliance on the market mechanism can more rapid economic development be achieved.

Moreover, in many instances tied aid is giving the picture of United States industry as being high cost. This is unfortunate because U.S. industry under open competition has held its own and has been quite competitive vis-a-vis other industrial countries. Since 1959, in all major markets - common market, EFTA, Canada, Japan, LDC's - the U.S. share has increased, reflecting a maintenance and even some strengthening of the U.S. competitive position. The tying of loans has, however, had harmful effects on supplier competition since this procedure has often required the recipient country to purchase equipment from a single national producer or a small group of producers. In a world which is becoming intensely more competitive, I am sure that we would all agree that American industry can, in the long run, hold its own abroad on the basis of efficiency.

In brief, I have tried to show that external transactions of the U.S. with the less developed countries is not a major factor in the U.S. deficit, nor have the LDC's been a drain on the U.S. gold stock. Incidentally, the positive contribution of the World Bank group to the U.S. balance of payments is about equal to the deficit of the LDC's with the U.S. The U.S. has found it necessary to introduce a number of measures such as tying loans to procurement and limitations on direct investment abroad and loans by U.S.

corporations. As I have said, the latter of these does not seem to have adversely affected the LDC's to a significant degree, but the former has. At the same time it has to be recognized that tying aid to procurement has certainly helped the U.S. balance of payments. In the absence of tying, the payments deficit is likely to have been considerably greater. An AID investigation suggests that the substitution of AID-financed for commercial U.S. exports is quite small in all but a few AID-receiving countries. They estimate that aid tying - AID, PL.480, and Export-Import Bank financing - may have increased U.S. commodity exports in 1965 by $1.63 billion f.o.b.

Thus, in view of the current U.S. balance of payments problem, it may well be unrealistic to suggest abandonment of tying. I would, however, like to suggest that any tying of aid for balance of payments reasons, either here in the U.S. or elsewhere, should be undertaken only after carefully weighing the disadvantages of this move to both partners in the aid relationship -- and that tying be held to a minimum. Moreover, more attention should be given to bringing tying practices of countries more into line with each other, thus reducing the complexities for the borrower; the impact of tying on the value of aid should be realistically assessed when computing the magnitudes of aid and taken into account when dealing with debt crises. Seen from an international viewpoint, in selecting commodities eligible for purchase with AID funds, it may be desirable to ensure that they are commodities produced by U.S. industries which are internationally competitive or come very close to being so, and try to avoid situations in which suppliers within the U.S. are so few as to lead to large over-pricing.

In conclusion, the balance of payments reason for tying should be regarded as temporary. Countries have had other reasons for tying such as

promotion of exports or to promote and strengthen a special relationship. Because of such reasons, some tying of exports may well become permanent. I hope that in the United States and elsewhere, the tying introduced for balance of payments reasons will not be continued after the balance of payments situation no longer requires their use.

city: Copenhagen (pop., 1965 est., 681,717). Language: Danish. Religion: the Danish Lutheran Church is the established church. King, Frederick IX; prime minister in 1966, Jens Otto Krag.

The members of EFTA had for many years been Denmark's biggest customers, and in 1966 they also became its biggest suppliers. The surprisingly large decline in exports from the Common Market to Denmark was generally assumed to be a consequence of the cut in duties within EFTA. The value of Danish imports of German cars fell by 180 million kroner in the first half of 1966, while imports of British and Swedish cars rose about 25 million kroner. A similar shift was apparent in the importation of clothing. As a whole, the Common Market's share in Danish imports had fallen from 39% in 1961 to 33% in the first half of 1966, while EFTA's share had risen from 33 to 38%. Over the same five-year period, the EEC share of Danish exports had fallen from 29 to 26% and that of EFTA had grown from 44 to 47%.

The agricultural policy of the Common Market caused severe difficulties for some branches of Danish agriculture, especially beef and cheese, and some agricultural leaders urged that Denmark join the EEC. A majority of the members of the Folketing, however, upheld the decision of 1961, that Denmark's entry into the Common Market should occur at the same time as that of Great Britain. Prime Minister Krag suggested in September that the Scandinavian countries examine the possibilities of Scandinavian adhesion to the Common Market, but Sweden, Norway, and Finland remained uninterested, preferring instead to develop EFTA further. All groups agreed upon the necessity of uniting the Common Market and EFTA and bringing the economic split of Western Europe to an end.

Full employment continued in 1966. The rise in production was estimated at 3%, but prices and wages tended to increase more rapidly. The inflationary trend slowed to some degree in the autumn, however, as the result of continued rationing of bank and credit society loans for housebuilding and for investments in agriculture and industry and of increased consumption taxes, instituted in February. In January the government and the Folketing agreed on legislation allowing an increase in rents during an eight-year period starting April 1, 1967, in order to close the gap between the rent for new flats and that for older flats, which had been frozen for several years. A part of the rent increase was to be used for loans to finance new housebuilding, and the state would subsidize the new buildings in order to keep rents from rising too high. It was hoped that housing would be fully liberalized by 1975.

This housing act was a compromise among the four major parties in the Folketing, the Social Democrats (the government party), the Radicals, the Agrarians (Venstre), and the Conservatives. The increase in consumption taxes had been opposed by the Conservatives, but was supported by the Agrarians and the Radicals as well as the Social Democrats. The split between the Conservatives and the Agrarians was generally assumed to be a result of the new leadership of Poul Hartling, who in 1965 took over the Agrarian Party from Erik Eriksen, and of the discussions between the Agrarians and Radicals begun in the autumn of 1965.

The municipal elections on March 8 resulted in Social Democratic losses and gains for the left-wing Socialist Party, the Radicals, and the Conservatives. In the following months the Social Democrats attempted to play down their cooperation with the right.

The plans of the Social Democrats, Radicals, and Agrarians to carry through a reform of the Danish taxation system were abandoned in May, and the political climate cooled during the summer. When the Folketing reconvened in October, the Social Democratic minority government proposed a tax reform based on a pay-as-you-earn system. This was strongly opposed by the Conservatives and Agrarians, and on November 2, Prime Minister Krag submitted his resignation and called for a general election on November 22. The Social Democrats lost 6 seats in the election, but their bloc of 70 was still the largest in the Folketing. The left-wing Socialists doubled their representation, raising their total number of seats from 10 to 20. An attempt by Prime Minister Krag to form a coalition with the Socialists failed, however, and he continued in office at the head of a minority government.

Krag visited French Pres. Charles de Gaulle on April 19. In May he visited West Germany and received the Charlemagne Prize at Aachen. Later he held talks with Chancellor Ludwig Erhard in Bonn in which European problems in general and the NATO problem in particular were discussed. (H. Ln.)

See also International Relations.

ENCYCLOPÆDIA BRITANNICA FILMS. *Scandinavia—Norway, Sweden, Denmark* (1962).

DENMARK

Education. (1963–64) Primary, pupils 562,108, teachers 20,548; secondary, pupils 126,468, teachers 11,657; vocational, pupils 157,937; teacher training (including higher), students 8,550; higher (at 47 institutions, including 2 universities with *c.* 19,200 students and *c.* 2,040 teaching staff), students 37,583, teaching staff 5,290.

Finance. Monetary unit: Danish krone, with a par value of 6.91 kroner to U.S. $1 (19.34 kroner = £1 sterling). Gold and foreign exchange, central bank: (June 1966) U.S. $520.8 million; (June 1965) U.S. $451.4 million. Budget (1965–66 est.): revenue 15,194,937,000 kroner; expenditure 13,335,000,000 kroner. Gross national product: (1965) 68,880,000,000 kroner; (1964) 61,580,000,000 kroner. Money supply: (April 1966) 19,020,000,000 kroner; (April 1965) 16,240,000,000 kroner. Cost of living: (1958 = 100): (April 1966) 142; (April 1965) 132.

Foreign Trade. (1965) Imports 19,488,000,000 kroner; exports 16,024,000,000 kroner. Import sources: EEC 37% (West Germany 22%, Netherlands 5%); U.K. 16%; Sweden 14%; U.S. 8%. Export destinations: EEC 26% (West Germany 16%); U.K. 23%; Sweden 12%; U.S. 8%; Norway 6%. Main exports: meat and meat preparations 22% (bacon 10%); machinery 12%; dairy products 10% (butter 5%).

Transport and Communications. Roads (1963) 60,100 km. (including 8,512 km. main roads, of which 80 km. expressways). Motor vehicles in use (1964): passenger 674,600; commercial (including buses) 231,200. Railways: (1964) 4,020 km. (including 2,448 km. state); traffic (1965) 3,214,000,000 passenger-km., freight 1,410,000,000 net ton-km. Shipping (1965): merchant vessels 100 gross tons and over 923; gross tonnage 2,561,599. Air traffic (including Danish contribution to international operations of Scandinavian Airlines System; 1965): 849,550,000 passenger-km.; freight 31,700,000 ton-km. Telephones (including Faeroe Islands; Dec. 1964) 1,310,746. Radio licenses (including combined radio-television; Dec. 1964) 1,619,000. Television licenses (Dec. 1964) 1,020,000.

Agriculture. Production (in 000; metric tons; 1965–66; 1964–65 in parentheses): wheat 557 (541); barley 4,125 (3,900); oats 792 (821); rye 265 (292); potatoes 937 (1,213); sugar, raw value *c.* 246 (436); butter (1965) 166, (1964) 156; cheese (1965) 115, (1964) 125; pork (1965) 806, (1964) 738; beef and veal (1965) 245, (1964) 244. Livestock (in 000; July 1965): cattle 3,354; pigs 8,590; sheep 90; horses (July 1964) 64; chickens 20,113. Fish catch (1964) 871,000 metric tons.

Industry. Fuel and power (in 000; 1965): manufactured gas 398,000 cu.m.; electricity (net, excluding most industrial production) 7,066,000 kw-hr. Production (in 000; metric tons; 1965): cement 2,010; pig iron 78; crude steel 412; superphosphates (1963) 738. Merchant vessels launched (100 gross tons and over; 1965) 252,200 gross tons.

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Dentistry

The year was notable for improvements in the design of dental chairs. The newest models made it easier for the patient to receive dental treatment under anesthesia, since they supported the patient more comfortably and thereby contributed to relaxation. With these chairs the position of the patient relative to the dentist could be adjusted by means of electric and hydraulic controls to give the dentist accurate access to his field of work, reducing his fatigue.

The search continued for a filling material having the qualities of permanence, compatibility with the dental tissues, colour that could be varied to match accurately that of the tooth in which it is placed, and of being readily usable in dental surgery. Widespread clinical trials of fibre glass suggested that a reasonably permanent material, suitable for restoring lost tooth substance and free from many of the disadvantages that present materials possess, may at last have been found.

That part of the body with the highest incidence of disease in civilized countries is the mouth. Almost everybody suffers from dental disease from early childhood until all the teeth are lost—and thereafter they may suffer from lack of teeth. In no country, however highly developed, are the health authorities satisfied with the ratio of dentists to general population; and emergent countries undoubtedly acquire a high incidence of dental disease along with their development. Therefore, the World Health Organization (WHO) has been endeavouring to obtain information on a global scale about the problem, with a view to determining and carrying out appropriate countermeasures.

At its annual session, at Tel Aviv in July, the International Dental Federation discussed with Mario Chaves, WHO's chief adviser on dental health, joint means of collecting and disseminating data on dentistry in various countries, under the headings of social and economic factors, epidemiology, preventive methods, manpower, existing and potential health services, current dental practice, and research. The intention was, first, to collect basic facts; then, as the project develops over the next few years, to produce comprehensive reference material which would assist those who have the responsibility for planning to meet the dental health needs of the various populations of the world. The inception of this project was probably one of the most important steps ever taken in the promotion of dental health.

Increased international exchange of knowledge, both in research and dental practice, requires an authoritative work giving translations of words and phrases that may not appear in interlingual dictionaries. The International Dental Federation therefore produced a lexicon containing 7,000 dental terms in English, French, German, Spanish, and Italian. This book was the result of five years of work by a team of multilingual dentists headed by P. O. Pederson of Denmark, and by the federation's headquarters staff. For those who read journals in a language other than their own or who attend world conferences, for translators, and for interpreters at international meetings, this work would be invaluable. Its production was made possible by a grant from the U.S. Public Health Service's National Institute of Dental Research.

Dermatology: *see* Medicine

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Development, Economic

In 1965 the less developed world as a whole showed a deceleration in the rate of growth of output, and the rate of growth of per capita output continued to be substantially lower than in industrialized countries. Although the paucity of data made yearly comparisons extremely hazardous, the average rate of growth in less developed countries seemed to have been between 4 and 5% in 1965, somewhat lower than in 1964.

Financial Position of Developing Countries. As a result of the continued growth in demand in the industrialized countries, the foreign trade of less developed countries increased further in 1965. Between 1962 and 1964 export earnings of these countries grew at a rate averaging almost 9%, reaching 9.5% in 1964. In 1965 the rate decreased to 7%, but was still above the average annual increase of 4.3% for the years 1950–65. The deceleration in 1965 was due primarily to a slowdown of growth in volume rather than to a fall in prices, although prices of primary commodities did decline. The World Bank's primary commodities price index for low- and medium-income countries fell by about 6% from the average of 1964. At the end of 1965, however, the index returned to the level it had reached at the end of 1964, mainly because of the continuing rise in the price of copper and the stronger position of grain and some tropical products. (*See* COMMODITIES, PRIMARY.)

Imports of the developing countries as a whole increased by only 4.5% in 1965, compared with 9% in 1964 and 5% in 1963. Most of the slowdown was experienced in Latin America and the Middle East. On the other hand, the developing countries in Africa and Asia raised their imports by 7.5% and 5.5%, respectively. The relatively slow growth of imports had been a major factor in the gradual decline of the combined trade deficit of the developing countries, from an average of more than $4 billion a year during 1960–62 to about $2.5 billion during 1963–64 and to $2 billion in 1965. Excluding the major petroleum exporters, however, the combined trade deficit amounted to $7.3 billion in 1965, about the same as the 1960–64 average. The developing countries also had a deficit of so-called invisible payments in 1965 of about $3.3 billion.

The largest source of finance for investment in developing countries was their own savings. The net contribution of foreign capital to investment varied widely among countries and, though it was not possible to generalize, might broadly be thought of as amounting to from 20 to 25% of the total. Thus, the bulk of the resources for economic development in the poorer countries continued to come from within, though foreign capital still played a critically important role.

Data on savings were often unreliable and became available only after a considerable time lag, but the available evidence suggested that developing countries were endeavouring to increase the ratio of savings to income. In at least 13, domestic savings reached or exceeded the relatively satisfactory level

of 15% of gross domestic product (GDP; gross national product less net foreign investment). In a number of developing countries the proportion of savings out of additional income (usually called the marginal savings ratio) was much higher than the average savings/income ratio, suggesting that the average savings rates over time would also be rising.

These countries were, however, only a fraction of the total number usually classified as developing. For the rest, savings rates were significantly lower, and a number of them had registered declining rates over time. Savings estimates made by the World Bank for 1964 for a selected group of countries showed wide variations in the levels achieved. Nearly twice as many countries in this group were below the 15% average level as were above it. In contrast, very few of the more advanced countries saved less than 20% of their GDP. This was the primary reason why, in absolute terms, the income gap between the rich and poorer countries continued to become larger.

Helped by the inflow of foreign resources, gross investment in most developing countries was higher than domestic savings. For 1964, in the selected group of countries for which estimates had been made, nearly two-thirds of the countries were above the average 15% level. From year to year, the ratio of investment to GDP had varied according to the level and movement of consumption—public and private—as well as the inflow of resources from abroad. According to UN estimates, there were indications that in the early 1960s investment tended to increase at a lower rate than production, largely because of a slackening in the inflow of foreign capital. Furthermore, the net outflow of interest and profits had risen rapidly and, by the end of 1964, was absorbing more than half of the net inflow of grants and loans.

The developing countries were trying to overcome these obstacles. Apart from efforts to increase savings and investment, considerable improvement had been made in the effective use of available resources through long-term development plans. Much valuable experience had been gained in drawing up such plans and, although implementation proved difficult, there was an increasing tendency to set realistic targets consistent with sound monetary and fiscal practices and with each country's available resources.

An area where progress was particularly slow was that of taxation and public sector savings. In many developing countries, taxation of high- and middle-income groups remained low, while government expenditures on less essential needs and on defense were rising. During the postwar years government consumption increased twice as fast as private consumption and much faster than gross capital formation. At the same time, the majority of these governments were saving relatively less than they had been ten years earlier.

Official Financial Assistance. This brief record of the developing countries' recent economic history must be viewed within the context of the international efforts being carried out to quicken their pace of growth. Both national agencies and the private sector in developed countries, as well as international organizations, continued to study the problems of development and to improve the means by which financial assistance was made available to developing countries. It needed to be stressed, however, that no number of financial initiatives on the international level could assure a more favourable future in the field of development unless efforts were simultaneously made by the countries themselves to solve some of their pressing domestic problems.

As the requirements for development finance in less developed countries continued to rise, a sizable part of the gap between the need for foreign exchange on the one hand and the ability of developing countries to export on the other had been filled by private foreign investment and loans, foreign aid by the governments of the industrialized nations, and financial assistance from multilateral institutions.

Naturally enough, external capital flowing into developing countries tends to seek out those investment prospects that meet high technical and economic standards. In the past, however, the lack of managerial, organizational, and technical expertise in developing countries often hampered the preparation of investment projects. Individual developed countries and private companies, as well as international organizations, were providing technical assistance to developing countries in order to increase their portfolio of projects and facilitate the inflow of foreign capital. Technical assistance by Western industrial countries totaled $1.1 billion in 1965.

The ability to prepare projects was not the only condition for facilitating a larger inflow of external capital, however. Both individual donor countries and international organizations, in their aid-giving policies, stressed that individual developing countries must follow satisfactory general economic policies as a condition for receiving increased financial assistance. These policy requirements tended to ensure that external capital would be utilized in the best possible fashion. By 1966, developing countries did have sufficient projects to justify considerably higher levels of capital inflow from abroad. The World Bank estimated that these countries could utilize some $3–$4 billion per annum more in development finance than had been available in the recent past.

While external capital needs of developing countries were rising, the supply of external capital from industrialized nations was showing signs of stagnation. A number of industrialized countries were experiencing serious difficulties in meeting the competing claims for investment resources within their own economies. Moreover, balance of payments difficulties were being experienced in the largest capital-exporting countries, the U.S. and the U.K. This not only imposed limitations on the size of capital exports from these countries, it also raised the cost of such

An American medical missionary rationing powdered milk to hungry children of the Turkana tribe in Kenya. Drought brought famine in 1966 to northern Kenya.

Table I. Total Official and Private Flow of Long-Term Financial Resources (Net)* from DAC Countries to Less Developed Countries and Multilateral Agencies by Country
In U.S. $000,000

Country	Official flows 1961	1964	1965	Private flows 1961	1964	1965	Total 1961	1964	1965
Australia	73†	107†	121	...	20†	23	73†	127†	144
Austria	2	15	34	18	7	14	20	21	47
Belgium	92	82	119	82	93	120	175	175	239
Canada	62	128	120	39	29	33	101	157	153
France	943	831	757	489	550	562	1,432	1,382	1,319
Denmark	8	11	13	25	21	3†	33	32	16
Germany, West	615	423	427	219	268	278	832	691	705
Italy	85	54	93	177	188	184	262	242	277
Japan	109	116	244	279	188	242	387	304	486
Netherlands	69	48	60	144	80	164	214	128	224
Norway	9	17	12	1	10	26	10	27	38
Portugal	44	62	21	...	...	9	44	62	31
Sweden	8	33	39	44	34	31	52	67	70
United Kingdom	457	493	480	444	415	443	901	908	923
United States	3,530	3,463	3,730	1,099	1,297	1,748†	4,629	4,760	5,478
Total	6,106	5,882	6,271	3,061	3,200	3,879	9,168	9,081	10,149

*Net of loan repayments and private capital repatriation.
†Estimate.
Source: Organization for Economic Cooperation and Development, *Development Assistance Efforts and Policies, 1965 Review.*

exports. Interest rates on long-term capital in U.S. and European capital markets were rising rapidly and in some cases had reached levels not experienced in many decades.

The tighter financial situation in a number of developed countries was reflected in the total volume of assistance to less developed countries after 1961. Table I shows that total assistance in 1964 was less than in 1961. In 1965, however, there was a reversal. While official financial assistance was at about the same level in 1965 as in 1961 (higher, however, than in 1964), private capital flows had risen substantially. The U.S. and Japan were the main contributors to the higher level achieved in 1965. The U.K., France, and Germany all contributed approximately the same amount in 1964 and 1965; their 1965 official assistance was actually lower.

Tighter financial conditions in developed countries were also reflected in the composition of financial flows. The share of grants in total assistance was declining markedly, and in 1965 was about 43%, as against 52% in 1963 (*see* Table II). The countries providing the greatest part of their aid in the form of grants were France and the U.S.

The decline in the share of grants was not accompanied by an easing of the financial terms of official lending to developing countries. Table III shows that terms actually hardened somewhat after 1962. An estimate by the World Bank of the weighted average terms on external public debt of 34 developing countries showed that, between 1962 and 1964, interest rates rose from 3.7 to 4.23%, while maturity shortened from 23.2 to 22.8 years. This was mainly the result of lending on harder terms by the U.S., traditionally a provider of low-cost loan capital. Because of the large size of the U.S. share, this hardening was not compensated in aggregate by the general softening of terms by other donor countries, even though the U.K. and Canada reduced their interest rates substantially.

In July 1965 a recommendation by the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD)

Table II. Total Flow of Long-Term Financial Resources From DAC Countries to Less Developed Countries and Multilateral Agencies by Type
In U.S. $000,000

Item	1963	1964	1965
Official bilateral (net)	5,712	5,441	5,773
Grants	4,040	3,837	3,798
Loans	1,677	1,500	1,954
Other	−5	24	21
Official multilateral (net)	411	441	497
Grants and capital subscriptions	415	452	528
Loans	−4	−11	−31
Private investment (net)	1,838	2,318	3,138
Private export credits (net)	552	881	741
Total	8,513	9,081	10,149
Grants as percent of total	52.3	47.2	42.6
Private investment and exports credits as percent of total	28.1	35.2	38.2

Source: United Nations, *World Economic Survey*, 1964; UN *Monthly Bulletin of Statistics*.

Table III. Average Financial Terms on Official Bilateral Loan Commitments

Item	Weighted average maturity periods (years)		Weighted average interest rates	
	1962	1965	1962	1965
Total DAC countries	23.6*	22.2	3.6*	3.6
United States	28.6	28.0	2.5	3.3
United Kingdom	24.3	22.1	5.8	3.3
France	17.0*	16.6	4.0*	3.7
Germany	15.2	16.9	4.4	4.2
Canada	11.6	30.1	6.0	3.8

*Based on incomplete data; for France, based on disbursements rather than commitments.

Source: United Nations, *World Economic Survey*, 1964; UN *Monthly Bulletin of Statistics*.

Table IV. Estimated Service Payments on External Public Debt of 97 Developing Countries*
In U.S. $000,000

Year	Latin America	South Asia and Middle East	Far East	Africa	Southern Europe	Total	Total as percent of merchandise exports
1960	1.4	0.4	0.1	0.1	0.3	2.3	8.1
1961	1.3	0.4	0.2	0.1	0.3	2.3	8.2
1962	1.3	0.5	0.3	0.1	0.2	2.4	8.4
1963	1.3	0.5	0.2	0.2	0.3	2.5	7.5
1964	1.7	0.7	0.2	0.3	0.4	3.3	9.2
1965	1.7	0.8	0.3	0.3	0.4	3.5	9.0

*These figures are derived from the latest World Bank estimates for 97 countries and include nearly all developing countries for which information exists. They cover service payments on both public loans and private loans guaranteed by the governments of debtor countries, all with maturities of one year or more.

Table V. Major Recipient Countries of Net Official Flows from DAC Countries and Multilateral Organizations
In U.S. $000,000

Country	1961	Percent	1964	Percent
Asia	2,235	40	2,935	47
India	662	12	1,230	20
Pakistan	264	5	518	8
South Vietnam	173	3	246	4
Africa	1,657	29	1,722	28
Algeria	433	8	252	4
U.A.R.	127	2	238	4
Congo, Dem. Rep.	87	2	115	2
Morocco	117	2	107	2
America	876	16	1,018	16
Brazil	342	6	233	4
Chile	130	2	132	2
Colombia	66	1	103	2
Europe	543	10	343	5
Turkey	178	3	149	2
Yugoslavia	164	3	136	2
Other	266	5	239	4
Total	5,577	100	6,257	100

Source: Organization for Economic Cooperation and Development, *Development Assistance Efforts and Policies, 1965 Review*.

urged donor countries to increase to about 80% the share of assistance in the form of grants or of loans with interest rates of 3% or less. Eight countries met the recommendation: Australia, Belgium, Denmark, France, the Netherlands, Norway, Sweden, and the U.S. Given the difficulties in the major capital markets, however, it seemed unlikely that financial terms on official loan assistance would improve substantially in the near future.

In 1965 the multilateral organizations concerned with providing financial assistance to developing countries (chiefly the World Bank, the International Development Association, the International Finance Corporation, the European Development Fund, the Inter-American Development Bank, the European Investment Bank, and various UN agencies) again increased their disbursements ($1.4 billion, as against $1.1 billion in 1964). Commitments rose even more (from $1.6 to $2 billion). The rise of interest rates in the international capital markets affected the operations of these institutions, however; the lending rate of the World Bank rose from 5.5 to 6% in 1966.

The increase in the interest rates charged by multilateral organizations implied a further rise in the debt burden of developing countries. These organizations, however, were conscious of the growing burden and were taking steps to remedy it by expanding the activities of those institutions that lend on more concessional terms (the International Development Association; the Fund for Special Operations of the Inter-American Development Bank). In this context must be placed the proposal by the president of the World Bank Group that the resources put at the disposal of IDA be raised to permit annual commitments by that agency of $1 billion per annum.

Table IV shows the rising debt burden of developing countries between 1963 and 1965, during which

period service payments on external public debt increased by $1 billion. The burden was, of course, unevenly spread among individual developing countries. The four largest debtors (India, Brazil, Argentina, and Pakistan) carried one-third of the outstanding external public debt of 97 developing countries. The increased burden meant that a number of countries had to reschedule their debt obligations vis-à-vis developed countries. Chile, Argentina, and Brazil had found it necessary to renegotiate their debt obligations. In 1965 and 1966 acute debt-servicing problems were experienced by Indonesia, Ghana, Guinea, Liberia, the Somali Republic, Syria, the U.A.R., Costa Rica, Haiti, and Uruguay.

Although debt service was increasing, a slowdown of debt accumulation on the part of developing countries as a whole was experienced in 1965. According to World Bank estimates, the total outstanding public external debt of the developing countries stood at about $36.4 billion in 1965, compared with $33 billion in 1964 and only $10 billion in 1955. Thus, it increased by about 10% in 1965, compared with a compound rate of about 14% between 1955 and 1964.

The distribution of public financial assistance among countries was changing. Between 1961 and 1964, less developed countries in Asia saw their share increase substantially, while countries in Europe witnessed a considerable reduction. The shares of Africa and Latin America, on the other hand, remained unchanged (28–29% and 16%, respectively; *see* Table V). The major recipient of public capital was still India, which in 1964 absorbed one-fifth of the total.

Private Capital Flows. While public financial flows remained stagnant, or increased less than proportionately to the growth of the industrial nations' wealth, private flows were rising. Although this might be due partly to better statistical coverage, the direction of the trend was unquestionable. Private capital flows to less developed countries take three main forms: direct private investment; purchase of stocks and bonds of existing companies in developing economies; and lending to public or private parties. The private sector of industrial countries also participates in the financing of activities of multilateral agencies by purchasing participations in their loans and by buying their bonds. Direct investment is the most important of these forms, representing about 60% of private capital exports. The U.S. remained the largest contributor. A complete statistical picture of the geographical distribution of private direct investment among developing countries was not available, but partial data for the U.S., France, and the U.K. showed that a large part of private investment tended to be concentrated in a few countries, particularly those producing petroleum. (*See* INVESTMENT, INTERNATIONAL.)

New Initiatives. A number of new initiatives were taken during the year in the field of development finance. The World Bank expanded its activity in aid coordination: consortia or consultative groups had been set up for India, Pakistan, Colombia, Malaysia, Nigeria, Peru, Sudan, Thailand, and Tunisia. The OECD organized consortia for Greece and Turkey, and the Inter-American Development Bank had a consultative group for Ecuador. Steps were being taken toward organizing similar groups for South Korea and Morocco.

Following more than a year of study, the staff of the World Bank in December 1965 put forward a scheme designed to protect development programs from the disruptive effects of unexpected export shortfalls by providing supplemental resources under certain conditions. The scheme was based on a close and continuing relationship between the administering agency and the countries concerned. As long as the economic performance of a country was satisfactory, judged by its adherence to agreed policies and programs, long-term finance to cover an unexpected shortfall from "reasonable expectations" would be made available. The plan received wide public support in many countries, as well as from the member countries of the appropriate committee of the UN Trade and Development Board. A small group of government representatives was set up to further study and elaborate it.

Mention should also be made of the revision in the International Monetary Fund's compensatory financing facility, under which primary-producing countries experiencing balance of payments deficits due to export declines could make drawings on the Fund up to specified amounts for a period of three to five years. In 1966 this facility, which came into existence in 1963, was revised to permit drawings of up to 50% of a country's quota in the Fund over a period of two years or more, instead of 25% as had been the case previously. Certain other features of the facility were also revised.

An important step in organizing assistance at a regional level was taken in 1966 with the establishment of the Asian Development Bank, with total contributions of $1 billion from Asian as well as other countries. The new bank was to be headquartered in Manila. The bank, like the Inter-American Development Bank and the African Development Bank (established in 1964), was primarily an operational lending institution at a regional level, but it was also likely to contribute to a closer coordination in development and assistance policies among the participants. (I. S. F.)

See also Agriculture; Economic Planning; Industrial Review; Inter-American Affairs; International Relations; Nuclear Energy; Payments and Reserves, International; Trade, International.

Worker unloading first air cargo of medical supplies sent by West Germany to Saigon in 1966 to aid South Vietnam.

Disasters

The loss of life and property in disasters during 1966 included the following. (*See also* METEOROLOGY.)

AVIATION

Jan. 14 Off Cartagena, Colom. Colombian DC-4 passenger plane crashed into the shark-infested waters of the bay moments after takeoff for Barranquilla; 56 of the 61 persons aboard perished.

Jan. 20 Sanghar, Thai. A crippled U.S. F-105 jet fighter fell into a small village and killed 16 Thai civilians who were unable to run to safety.

Jan. 22 Duchiti area, Haiti. Haitian DC-3 commercial airliner crashed near the southwest coast killing 30 of the 35 persons aboard.

Jan. 24 Near Chamonix, France. Indian 707 jetliner, on a flight from Bombay to Geneva, rammed into a fog-obscured ridge about 45 ft. below the summit of Mont Blanc; all 117 persons aboard died.

Jan. 25 Ankhe, S. Viet. U.S. Air Force C-123 transport, taking off in bad weather, plunged to the ground and burst into flames; 46 U.S. infantrymen and crewmen were killed.

Jan. 28 Bremen, Ger. Twin-engine German airliner overshot the Bremen Airport landing strip, exploded, and burned in a nearby field; all 46 persons aboard died (including 7 members of an Italian swimming team).

Feb. 2 Faridpur, Pak. Pakistani S-61 helicopter, en route from Dacca, fell to the ground in flames when a vulture flew into the rotor blades; 23 persons died, 1 survived.

Feb. 4 Tokyo, Jap. Japanese 727 jetliner, completing a flight from Chitose and only moments away from the airport, plunged into Tokyo Bay amid a pillar of flame; all 133 persons aboard perished—the highest number of fatalities, to date, in a single plane disaster.

Feb. 7 Banihal Pass, Kashmir. Indian F-27 propjet on a Srinagar-to-New Delhi flight, disappeared in the Himalayas

Diamonds: *see* **Mining**

Swiss police searching for wreckage of the Indian 707 jet which hit Mont Blanc near Chamonix, France, during a fog on Jan. 24, 1966. All 117 persons aboard were killed.

during a storm; all 37 persons aboard died.
Feb. 17 Moscow, U.S.S.R. A Soviet TU-114 airliner, scheduled to inaugurate a service to Brazzaville in the Congo Republic, skidded in wet snow at takeoff and split in two; 48 of the 70 persons aboard were reported killed.
March 4 Tokyo, Jap. Canadian DC-8 jetliner, en route from Hong Kong to Buenos Aires, in making a landing in fog at Tokyo's International Airport, snagged the approach lights, struck a breakwater wall, and careened down the runway in flames; 64 of the 72 persons aboard were killed.
March 5 Near Tokyo, Jap. British 707 Tokyo-to-London airliner, moments after takeoff, caught fire about 3,000 ft. above the summit of Mount Fuji and crashed on the eastern slopes; all 124 persons aboard were killed.
March 18 Cairo, U.A.R. U.A.R. Soviet-built AN-24 plane, en route from Cyprus, crashed and burned while attempting a landing at Cairo Airport during a sandstorm; at least 30 persons perished.
April 22 Near Ardmore, Okla. U.S. Electra propjet, chartered to transport a group of U.S. Army recruits from Fort Ord, Calif., to Fort Benning, Ga., crashed when it missed the Gene Autry Airport runway while making a fuel stop during a rainstorm; 76 recruits and 6 crewmen perished, 16 servicemen survived.
April 27 Coclococha, Peru. A Peruvian Constellation airliner, en route from Lima to Cuzco, crashed in the Andes; all 49 persons aboard were killed.
Aug. 6 Falls City, Neb. U.S. BAC-111 New Orleans-to-Minneapolis jetliner plunged in flames and exploded in a muddy soybean field; all 42 persons aboard were killed.
Aug. 11 Near Bucharest, Rum. A Rumanian airliner en route from Cluj to Bucharest crashed and killed all 24 persons aboard.
Aug. 17 Danang, S. Viet. U.S. Marine F-8E Crusader jet suffered engine failure moments after takeoff, plunged into a small village, and killed 26 Vietnamese civilians, 15 others were injured.
Sept. 1 Ljubljana, Yugos. British-chartered Britannia 102 turboprop, carrying vacationing Britons from London to Ljubljana, struck treetops as it approached the airport runway, hit the ground, and burst into flames; 97 of the 117 persons aboard died.
Sept. 22 Queensland, Austr. An Australian Viscount airliner on a flight from Mt. Isa to Longreach, Queensland, crashed and killed 24 persons aboard the plane.
Oct. 1 Near Squaw Mountain, Ore. U.S. DC-9 jet en route from San Francisco to Seattle plunged into a mountain ravine and burned; all 18 persons aboard died.
Nov. 11 Off Nantucket, Mass. U.S. Air Force radar picket plane plunged into rough seas and sank with 19 crewmen aboard; all were presumed dead.
Nov. 13 Near Matsuyama, Jap. Japanese YS-11 turboprop on a scheduled flight from Osaka to Shikoku Island overshot the runway, then as it circled for a second try, plummeted into the Inland Sea; all 50 persons aboard (including 11 honeymooning couples) were killed.
Nov. 22 South Arabia. An Aden DC-3 commercial plane flying from the Wahidi Desert area crashed moments after taking off for Aden; all 28 persons aboard died.
Nov. 24 Bratislava, Czech. Bulgarian IL-18 turboprop, resuming flight after an unscheduled foul-weather landing, crashed in the nearby Carpathian Mountains; all 82 passengers and crewmen were killed.
Nov. 26 Tan Son Nhut, S. Viet. U.S. Air Force C-47 transport, attempting an emergency landing immediately after takeoff, nose-dived into a rice paddy and exploded; all 27 Americans aboard perished.
Dec. 18 Bogotá, Colom. Colombian Super Constellation en route from Miami, Fla., missed the runway and crashed as dense fog closed in on El Dorado Airport; 18 of the 59 persons aboard were killed, and at least 10 others were hospitalized.
Dec. 24 Binh Thai, S. Viet. U.S. CL-44 cargo-transport, en route from Tachikawa, Jap., to the Da Nang Air Base, crash-landed in a heavy rainstorm, smashed into a small village, and burned; 125 Vietnamese civilians and the 4 U.S. crewmen were killed, and 42 civilians were injured.

FIRES AND EXPLOSIONS

Jan. 18 T'ai-pei, Formosa. Fire destroyed one of the city's largest buildings, the Cosmopolitan dance hall, killing 28 persons, most of them hostesses in the hall.
Jan. 18 Seoul, N. Korea. An overheated stove caused a fire that burned down more than 100 shacks in a slum area; 23 persons, many of them children, perished; more than 2,000 others were left homeless.
Jan. 28 Boston, Mass. An explosion and fire wrecked two hotels and brought death to at least 12 persons; about 60 others were injured.
Feb. 4 Buenos Aires, Arg. A factory explosion killed 13 persons and injured 20 others.
Feb. 6 Miami, Fla. Fire swept through a crowded tenement building killing 10 persons, 7 of them children.
Feb. 7 Iloilo, P.I. A large section of the city was razed by a fire that caused damages estimated at $14 million; 18 persons died, 12 others were missing.
March 11 Numata, Jap. Two ski resort hotels were destroyed in a predawn blaze that took the lives of 31 persons.
April 23 Lapinlahti, Fin. Fire broke out in a mental hospital and destroyed the building within two hours; 29 patients perished.
April 26 Amraoti, India. More than 500 persons were evacuated from a slum area when a nearby cottonseed oil mill was leveled by an explosion and fire; 32 mill workers were killed and 26 others seriously injured.
May 1 Vitoria, Braz. Fire caused an explosion in a warehouse stored with dynamite and fireworks; 14 persons died, 56 others were injured.
Aug. 13 Melbourne, Austr. A Salvation Army hotel went up in flames, trapping most of the guests; 29 persons perished—the greatest toll in any single fire in Australia's history.
Sept. 6–8 Near Sintra, Port. Forest fires in the Sintra Mountains brought death to 37 soldiers who were among the nearly 4,000 fire fighters.
Sept. 12 Anchorage, Alaska. Fire of unknown origin destroyed the Wooden Lane Hotel and burned to death 14 persons.
Oct. 9 Bulacan Province, P.I. A half-ton of firecrackers exploded in a fireworks factory; several houses were leveled, and 14 persons killed.

New York City firemen battling the five-alarm blaze which claimed the lives of 12 firemen on Oct. 17, 1966.

Oct. 11 Tamaulipas, Mex. A two-story building was destroyed by fire in which 12 persons of the same family died.
Oct. 13 La Salle, Que. Explosions ripped through a chemical plant when a chemical reaction went out of control; 11 persons were killed, 10 others injured.
Oct. 17 New York, N.Y. A stubborn five-alarm fire in a commercial building in the Madison Square area took the lives of 12 firemen, all from Engine Company No. 18; it was the greatest single toll in the New York Fire Department's 101-year history.
Oct. 31–Nov. 4 California. Brush fires in the hill country of southern California accounted for 16 lives: 4 U.S. Marines and 12 members of the "El Cariso Hot Shots," an elite fire-fighting unit.
Dec. 7 Near Erzurum, Turk. Gas stove explosion ignited a fire that raged through the Dumlu barracks killing at least 68 soldiers and injuring 24 others.

MARINE

Jan. 5 Off the Faeroe Islands. Soviet fishing trawler sank; 14 of the 24 men aboard were reported missing.
Jan. 10 North Atlantic Ocean. Spanish freighter, the 10,500-ton "Monte Palomares," sank in storm-tossed waters about 840 mi. NE of Bermuda; 32 of the 38 crewmen aboard died or were lost and presumed dead.
Jan. 25 Belawan, Indon. Indonesian state-owned oil company ship "Permina" sank near the North Sumatra port of Belawan; 89 of the 200 passengers drowned.
Jan. 31 Off Kuril Islands. Two Japanese fishing boats were reported lost in a North Pacific storm; 30 crewmen were presumed dead.
Feb. 16 Nagoya, Jap. Japanese tanker, the new 33,800-ton "Bridgetown Maru," was gutted by fire as it lay in the harbour; at least 16 workmen were killed.
Feb. 19 Off La Coruña, Sp. Two fishing boats foundered in a violent Atlantic storm and claimed the lives of 17 seamen.
March 24 Escondido River, Nic. An overloaded river launch capsized and sank, drowning 19 persons.
March 27 North Sea. Winds of 100 mph buffeted the oil

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international problems of **ECONOMIC DEVELOPMENT**

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INTERNATIONAL PROBLEMS OF ECONOMIC DEVELOPMENT

I have been connected with international institutions for most of my professional career — namely, the Fund and the World Bank Group since their inception—and I thought it may be of some interest to you if I were to talk today about the economic issues and problems which arise at the international level and which constitute the bulk of my work.

Let me sketch in broad outline three major features of the problems that confront economists dealing with problems of development at an international level of action and policy.

We are engaged in the process whereby the advanced industrial countries have come to the assistance of the less developed countries (LDC's) in order to accelerate their development. This process, whereby one group of nations has recognized an obligation to help accelerate the economic development of another group of nations, has become so familiar a feature of our daily newspaper reading that we sometimes forget what a profound new development this is in human affairs. Professional historians have noted this fact and have suggested that this development may well be the most distinguishing feature of our age.

This development has, at the same time, raised a number of questions with regard to the nature of international economic relationships which go far beyond the confines of the existing theory of international trade and finance. For the present, let me pick out just two questions which are of very particular interest to us as economists in the World Bank Group. The first is the question of *burden-sharing*—on what principles is the quantum of aid to be divided among the aid-givers?

At present a great deal of aid effort is organized bilaterally, and historically it has been dominated by a variety of political factors. A part of the aid is, however, through multilateral channels, and of late an increasing part of bilateral aid has come to be organized on an international basis through various coordinating mechanisms such as consortia and consultative groups. We have been involved in this, since most of these coordinating mechanisms have been devised under the aegis of the World Bank. One of our concerns here has been to increase the role of economic calculus in the search for criteria by which the international aid effort can

be shared among the donor countries. This is not easy, and, as recent discussions have shown, there are even problems in measuring the burden to the donor countries of the assistance they provide. This assistance is provided under such different terms and under so many constraints on its use by the recipient countries that a comparison of the nominal amounts is clearly not adequate as indicating the relative burden borne by these countries.

Various approaches have been made to this problem of burden-sharing; there are, for example, various proposals to link the total aid provided by each individual donor country to some percentage of national income. Then there is the approach which has related the amount of official aid to the budgetary situation in each country. Another important economic factor that has played a role in this question is the balance of payments effect of aid. Flows of aid, representing a transfer of resources overseas, enter the balance of payments of a donor country as an extraneous element not directly related to the economic activities of consumption and production. A transfer of resources overseas without a corresponding matching in terms of aid-financed commodity exports may alter the relative balance of payments situation of countries.

This kind of concern with the balance of payments has been an important reason—though by no means the only one—behind tying of bilateral aid to procurement in the country providing funds. But on the other side of the picture, the use of such tied aid creates some problems for the recipient countries. The inefficiencies associated with aid-tying, principally in terms of the higher prices the LDC's have to pay for their aid-financed purchases, have been widely discussed elsewhere by professional economists and by representatives of developing countries in various international forums. Estimates indicate that tying results in about a 15 per cent increase in prices of commodities financed by aid; for some individual countries the percentage is even higher. The inefficiencies which tying introduces have weighed so heavily that the Bank and the International Development Association (IDA) in their operations have insisted on international bidding in the use of funds. The economic question in this is how to reconcile the advantages of international competitive bidding from the viewpoint of developing countries with the consideration of the balance of payments effects of such a procedure on industrial countries in balance of payments difficulties. Or to put it another way, the question of economic interest is not how to take aid out of the balance of payments but

rather how to take the balance of payments out of aid. The answer for some is that the magnitude of development assistance should not be related to balance of payments positions; any disequilibrating payments effects should be offset by available equilibrating measures. The problem should be thought of purely in resources terms. This issue of the relation between assistance and balance of payments is now of critical importance in current negotiations on various proposals in development finance.

* * *

While these are some of the problems on the side of burden-sharing by the rich nations, there are equally complex problems in the flow of aid to the developing countries. Among these problems are the amounts of assistance to be given to particular developing countries; the purposes for which such assistance is given—for specific projects, for general import-financing, for budgetary support, etc.; the relative amounts of grants and loans; the terms and maturities of loans; the relation between debt-servicing and net flow of assistance, etc. Each of these problems raises a host of others. If I may, I will comment today only on the problems of *aid allocation*.

The total volume of aid today is not adequate to provide all the funds which the developing countries could productively use for their development, hence the need for some criteria by which aid can be allocated. So far political considerations have dominated the allocation of bilateral aid as shown, for example, by the extent to which aid from particular countries is largely concentrated in particular regions—French aid to the franc area, British aid to the former Empire, U.S. aid to Latin America—and this has brought to the forefront of aid discussions the question whether and what economic criteria are at all applicable in this field. The obvious criterion of relative poverty as a principle of allocation of aid is not entirely satisfactory from the point of view of ensuring that development assistance is put to the most productive use. To ensure the effective use of aid, therefore, there is today increasingly a search for some sort of performance criteria which would relate aid to economic performance by developing countries.

There is as yet no clear agreement among economists on what criteria should be appropriately applied in judging performance—nor indeed on the precise meaning of the concept itself. What interpretation should be given to this concept? Is "performance" the same thing as creditworthiness of a country in terms of its ability

to service more loans? Should it be judged in relation to the extent to which countries attain the targets of their development plans? Or is it its adherence to what might be considered "right" policies irrespective of the results obtained? Or should it be identified with the degree of success which a country has achieved in its economic affairs, irrespective of the amount of aid it has received, and irrespective of the favorable or unfavorable accidents which have attended its domestic activities or its foreign trade and other relationships?

There are no clear answers to the question of evaluating performance in developing countries, either in theory or in practice. Economic science has been traditionally concerned with questions of efficiency and welfare which one might have thought would provide us with some criteria for evaluating performance. But we do not get much help here. On the one hand we have elegant models, which rarely get out of algebra into arithmetic using reliable numbers; on the other hand we have the rule-of-thumb approach, i.e., some universal formula based on some simple relationships. For example, a formula which would measure performance in terms of the increase in government capital formation as a proportion of GNP over the past few years. Then, there is the notion of various "correct" policies that should be followed to maximize economic welfare, with which economic science has been grappling ever since its birth—the use of the price mechanism and competition, the encouragement of investment and innovation, the promotion of foreign trade, etc., but the problem of formulating them in such a way as to take account of the great variety of circumstances found in the developing countries still remains largely unsolved.

In practice, it has been customary to consider the performance of developing countries by the rate of growth of their national income in the past as well as the rate of growth likely in the future. Judgments on likely future rates of growth are arrived at on the basis of judgments on whether a country is having a satisfactory amount of savings and investment, whether it is allocating its resources properly, whether it is having a proper monetary policy, whether it is maintaining the right rate, and so on. It has been a mixture of objective criteria and subjective judgments.

The use of the national aggregates, especially the rate of growth of national income, as a guide to performance is not entirely satisfactory, *per se,* since the efforts which the poor countries have to make to promote their own development is not necessarily re-

flected in the growth of their national incomes in the short period. These countries are interested in economic development because they want to achieve higher living standards ultimately, but the pattern of investment that they choose to achieve this may offer little immediate returns. For example it is now more and more widely recognized that the developing countries must first achieve a basic structural transformation of their economies, particularly in order to harness modern science and technology to their production systems. An essential aspect of such a transformation is the building up of sufficient amounts of physical and social infrastructure, even at times ahead of the demand for such facilities. The real justification for these investments is not that they by themselves would lead in the short run to growth of the national incomes of these countries, but that they will eventually increase the returns to directly productive investments.

Let me illustrate the way in which national aggregates can hide the extent of progress made in the field of development with the example of India. Over India's first three plan periods covering the 15 years 1950 to 1965, the national output in India increased at a little more than 3 per cent per year and per capita output by slightly over 1 per cent per year. This is quite modest, and may even be disquieting, but at the same time between 1950 and 1963 installed electricity capacity increased 230 per cent, and 93 per cent of the towns and villages counted in the 1961 census were electrified by 1966; railway goods traffic increased by 142 per cent; railway passenger traffic by 33 per cent; the number of doctors by 39 per cent; the literacy rate increased from 16.6 per cent in 1951 to 24 per cent in 1961; the enrollment ratio for primary education increased from 43 per cent in 1951 to 67 per cent in 1961, and so on. Are these not the sort of changes that are necessary for a country's development, in whatever way development as a process of modernization may be defined?

It is for this sort of reason that I have increasingly felt that in judging performance, we should try to get away from simplistic notions of national income growth. All major aspects of the economy need to be considered. In judging performance we should also look to the efficient implementation of projects within an over-all development strategy, and the contribution a country itself makes to the financing of these projects in relation to its capacity. Within the Bank we are still debating the issues of how to judge performance, as I am sure some of you are too. We have no dogma on the subject nor do we want to give undue weight to the past. Instead,

we have often used what might be called the "policy approach," whereby we agree with member developing countries on certain policies they should follow in the future to promote their best feasible development, e.g., monetary and fiscal policies designed to accelerate resource mobilization, incentive taxation, forward planning of investments, etc. Agreement on these policies is arrived at through a continuous process of consultations, and as long as the country implements these policies, its performance is judged adequate for purposes of future assistance from the Bank Group. In some cases, even this approach is not feasible, and the problem of judging performance for the purpose of Bank lending becomes quite perplexing. One such case is that of a country which has no record of good past performance, and no commitment to future policy actions which would give adequate priority to development and which could be agreed internationally. At the same time this is a country with vast reserves of an important mineral resource with a high and increasing export demand, which it wishes to develop with the help of an international project loan. What should the Bank do? Should it accept the argument that a successful exploitation of this mineral resource is vital enough for the future economic development of the country for it not to bother with the general governmental economic policy? Or should it wait for improvement in government policies for development before agreeing to lend, with the expectation that the country's eagerness to obtain financing for such an attractive project will help induce the country to adopt better economic policies? Fortunately these situations are exceptional, but they do illustrate some of the knottier problems which may arise in evaluating performance.

The Bank's interest in the economic performance of the developing countries in recent years goes far beyond its own immediate lending operational needs. One of the important functions that the Bank assumes in agreeing to organize a consultative group for any country is to make periodic comprehensive economic reports on the country's development possibilities, problems and performance as a basis for the Group's deliberations. There are now 11 developing countries which are covered by consultative groups or consortium arrangements chaired by the World Bank. In addition, we undertake economic reviews for our own purposes, evaluating the performance of our member developing countries; last year we made such reviews for 45 countries, and since March 1965 for 73 countries. As a part of these responsibilities, we are continuously in search of more explicit performance criteria which can be applied consistently among the less developed countries.

This whole question of performance brings me to the second group of problems of development, namely, the role of economics in the practical task which the developing countries face in promoting their own development with their own resources and with external assistance.

The task ahead of the developing countries, as has been often pointed out, remains a long and arduous one. They still have to make an enormous effort to raise their economies to a level where they can exploit modern science and technology, their main hope for rapid progress in a world where the other countries are advancing so fast already. For this purpose, the developing countries have to bear heavy sacrifices of present consumption, already at a pitifully low level, in order to make investments for the more or less distant future. A myriad of problems confronts their leaders in the painful choices they have to make, between consumption and investment, between quick returns and long-run goals, between social stability and economic growth, etc. They bring only limited experience to this unfamiliar task. There are inescapable political factors in the decisions actually made by their governments. In the face of all these difficulties, we have to find methods of evaluating the priority given to development, which would recognize the political element in decision-making, and yet be economic and objective enough to escape narrow political bias.

The process whereby policy decisions are translated into concerted public action and private response is necessarily slow and it is not surprising, therefore, that some of us are at times discouraged by the pace of development in the developing countries. It is still a fashionable exercise to predict a gloomy future for them in terms of an ever-widening gap between them and the advanced countries by projecting rates of growth observed in the recent past. GNP per capita in developing countries (excluding Sino-Soviet countries) for which we have data has been growing at the rate of 1.8 per cent per year over the period 1960-65. The rate of growth of GNP per capita in the United States and Germany has been, on the other hand, 3.2 per cent and 3.5 per cent, respectively. If the per capita income of these countries were to be extrapolated on the basis of past trends, in 1980 the per capita income of LDC's, which now stands at around $150 per year, would still be only $195. For particular regions and countries, especially those of South Asia, prospects on the basis of a simple extrapolation would be even bleaker. As against this, per capita income in the United States would have increased to $5,060 per year from the present level of $3,160; and in Germany from $1,590 to $2,650.

I, for one, do not share in this pessimism. By its very nature, economic development is not a simple extrapolation of steady rates of growth; it is a deliberate attempt to accelerate and change existing trends. There are increasing signs that the investments of the past decade and those of the next will make a decisive change from the past stagnation, which, in many cases, goes back to the 1920's or earlier. What is perhaps less apparent is the great improvement that has taken place in the way the less developed countries are organizing their development efforts by the use of planning techniques. On a recent count, at least 50 countries have adopted partial or comprehensive development programs. Some of this planning has been faulty and, at times, even useless. But behind these weaknesses lies a truly remarkable phenomenon—the acceptance of the planning technique. By planning technique in this context, I do not mean a detailed control and regulation of economic activity. Rather, it is the method by which governments make commitments to future actions and policies, thus extending the time horizons within which economic calculations based on objective criteria can play a greater part. The planning technique then becomes an important instrument for coordinating development activity on a number of different fronts, and for maintaining some sort of continuity in the pace of development. Seen in such a broad perspective, the progress that has been made is considerable, and what is needed now is to push further the basic planning ingredient of commitment to future action on a coordinated basis, consistent with the possibilities of practical implementation. While the improvements in the use of the planning technique promise to make the development efforts of less developed countries more successful in achieving their goal, it also provides a convenient framework by which the international community can make an over-all evaluation of the development program and priorities, and at the same time a focus toward which international development assistance can be directed.

* * *

A third important feature of the economic problems that we have to deal with is to find ways in which we can assist the developing countries in the *mobilization of resources* for their development. There are a number of ways in which they can raise and utilize more of their own domestic resources for this purpose, but a particularly stringent constraint for most of the developing countries is in their foreign exchange earnings and receipts. To these countries, the means to pay for foreign goods and services are crucial because they must rely on imports for the capital goods

which they cannot produce themselves at their lower level of technological development. However, the developing countries generally face serious structural difficulties in transforming their domestic resources into foreign exchange under present conditions of world trade. The difficulties which the developing countries face in commodity trade has been the subject of extended discussions and negotiations between the advanced countries and the LDC's in the UNCTAD, GATT and elsewhere. The other source of foreign exchange for the LDC's is the flows of official and private capital from advanced countries. This, of course, is of very immediate interest to us in the Bank, and there are many economic questions which arise in dealing with the appropriate terms, level and nature of such assistance, but I would mention only one of these, namely, the concept of external capital requirements of developing countries. The concept of capital requirements is an indication of the total amounts that less developed countries can productively use for their development and as such is one of the factors that the donor countries have to take into account in their decisions about the scale of their assistance to the developing countries. In recent years attempts have been made in the World Bank, the United Nations, the U.S. Government and elsewhere, to estimate the external finance needs of the less developed countries. The methodologies by which these estimates are arrived at differ considerably. The approach we took was based on individual country experience. Considered judgments were made by our country economic staff regarding feasible growth in income, investment and savings, imports and exports for each country taken individually. Our analysis showed that the developing countries as a whole could effectively absorb over the next five years an additional capital inflow of $3-4 billion per year. Notwithstanding the informational gap in such estimates, these projections do indicate that even with relatively optimistic assumptions about the growth of exports and effective mobilization of savings as compared to historical trends, there is likely to be for some time to come an increasing requirement for net foreign exchange resources, if these countries are to sustain rates of growth which are compatible with their capabilities.

* * *

All these three features that I have described, of coping with the economic problems of development at an international level, find a place in one of the exercises we began in 1965. This is the preparation and international consideration of the *Study on Supplementary Financial Measures* that we did in response to a request from the United Nations Conference on Trade and Development in

1964. This was a study aimed at devising a way of assisting the LDC's to meet the problem of unexpected export shortfalls which threatened to disrupt their development program, and which were of a nature and duration which could not be met by short or medium-term balance of payments support. We aimed at producing a viable scheme based on economic research and analysis.

The first question we asked ourselves in undertaking the study was whether there was a problem and, if so, how big the problem was. The instability in the international trade in primary goods, which constitute the bulk of the exports of the LDC's, has been recognized for some time. The notion of instability is quite complex and cannot be completely captured in any simple statistical index. It is only too easy to devise a statistical measurement, call it an "index of instability," and then practically define instability as that which is measured by such an index. Several such indices have appeared in recent years, on the basis of which some authors have even questions whether there is a problem arising from export instability in the LDC's. Our own studies have persuaded us that export instability is particularly important in the case of primary goods and is a serious problem for the LDC's—much more serious than for the developed countries. Moreover, this question of instability had been studied in some detail by the IMF staff in providing the intellectual basis for the IMF Compensatory Financing Scheme. This facility, as you know, came into existence in 1963 with the purpose of assisting "members, particularly primary exporters, encountering payment difficulties produced by temporary export shortfalls." The Fund has defined the "norm" as a moving average for five years centered on the current shortfall year so that there would be a rough balancing of shortfalls and surpluses over a reasonable period of time. The assistance provided under the facility is within the framework of normal Fund operations—to be repaid in three to five years, thus maintaining the revolving character of the Fund's resources.

There is, however, another aspect of the problem of instability which is not dealt with by the Fund Compensatory Scheme nor covered by the usual discussion of instability, namely, deviation in export earnings from *anticipated* earnings on the basis of which a program for development over medium-term periods of about five years has been based. These deviations are not measured from extrapolations of past trends but rather from estimates of future expectations. A key aim of development is often to bring about by deliberate policy measures a change in past trends in export performance. This kind of instability with the consequent uncertainty could not be measured by moving averages or similar measures nor dealt with by short-term balance of payments support.

Having isolated the nature of the problem, to which the UNCTAD resolution addressed itself, we next tried to estimate the size of the problem. We wished to test empirically whether the "adverse movement in export proceeds" (and which was defined in the resolution as "a shortfall from reasonable expectations") had been a major problem. In keeping with the logic of the resolution, we defined reasonable expectations as estimated future export eventualities incorporated in an objective export projection within the context of a development program. Establishing the size of the problem involved relating "actuals" to "expectations," and we had to know not only what *had* happened in the past but also what people expected *to* happen at any particular point in the past. Furthermore, we had to be confident that what was done in the past was reasonably objective and could be used as a basis for judging the reliability of the export projections which had been made. It was impossible to have precise data to conduct the exercise, since our concept was a new one. Fortunately, however, we had an available body of experience within the Bank which could be used. As part of the process of determining the creditworthiness of prospective borrowers and their economic positions and prospects of development, the Bank in a considerable number of cases had projected exports of developing countries for a period of years ahead. Some of these projections had been made entirely by the Bank staff, some had been made originally by technicians in the member countries and modified by Bank economists or accepted by them after analysis, as reasonable. We decided to use these projections made in the past as raw materials for developing the "expectations" side of our analysis, and to compare with them the export performance of the same countries on the basis of available trade statistics. An examination of Bank reports yielded 113 quantitative projections made by Bank economists for 37 countries during the years 1949-64, inclusive, covering projections extending for various periods of time, but typically five years, into the future. Where these projections overlapped for any country, they were combined together into a "composite projection"; this was used as a measure of "reasonable expectations" for a comparison with actual export performance. We then measured each country's actual export earnings against the projected values to derive a series of country-by-country, year-by-year shortfalls and what we called "overages"—earnings *above* expectations. This analysis demonstrated that shortfalls below ex-

pectations had been significant for a number of countries, though the number of countries affected and the intensity of shortfalls varied from year to year.

However, this analysis had an important limitation in that the number of countries in the sample varied considerably from year to year. We therefore decided to extract from the list of countries for which composite projections were possible two sample groups, one consisting of 14 countries for the seven-year period 1957-63 and another of 18 countries for 1959-63. (The first sample comprised Brazil, Burma, Colombia, Costa Rica, Ecuador, El Salvador, Ethiopia, Guatemala, Mexico, Nicaragua, Pakistan, Peru, Thailand and Sudan. The second sample comprised all of these plus Argentina, Panama, India and Tanganyika [now Tanzania].) When the results obtained on the basis of the two samples were extrapolated to a global basis, this exercise yielded an estimate of $1.6 billion per year of total gross shortfalls, i.e., without subtracting the "overages" earned by the same countries. Export projections are now being done in the Bank for nearly all countries, unless statistically impossible.

The next question that we tackled was the causes and effects of export shortfalls. We again took the empirical approach and made a number of special case studies of country experience. We reconstructed the economic experience of these countries as best we could. We had the help of economists with rich experience of these countries and our past economic reports based on field investigations and country policy memoranda, as well as the published literature. We found that, in a number of cases, an unexpected export shortfall had in fact resulted in slowing down, and even halting, planned investment, and had led to hastily mounted import restriction programs which impeded efficiency, particularly in the industrial sector, as well as emergency cutbacks in private and public investment through monetary and fiscal policies. The axe has usually fallen on long-term—but basic—investments, resulting in a loss of momentum in the development effort. In a number of these cases, the export shortfall was due largely to unexpected movements in supply and demand conditions abroad, over which the affected country had no control. To illustrate, let me give you an example—that of Colombia in the early 1960's. In Colombia there has been a significant shortfall in exports below the plan target made in 1961, largely because of the fall in coffee exports in the 1960's. Though some decline in coffee prices had been expected, the extent of that decline could not have been anticipated on any reasonable basis. The most immediate effect of the shortfall in export earnings was in the slowing down of the rate of growth of industrial output. The rate of capital formation in Colombia is heavily dependent on the flow of imported machinery and equipment which increased by some 20 per cent in 1960 and 7 per cent in 1961, but declined by 13 per cent in 1962 and 19 per cent in 1963. Actual investment expenditures of the national government in 1963 were less than two-thirds of the target established under their plan which had been received by the World Bank staff. The major victim of the government retrenchment was transport investment.

Thus, we concluded on the basis of past experience that the problem of unexpected export shortfalls was a real one for many developing countries and that this constituted a serious danger to the process of planned development in these countries. A new scheme was therefore needed to meet this problem. The scheme we proposed is now being discussed by an expert group of governmental representatives consisting of 14 developed and developing countries set up by the Trade and Development Board of the United Nations.

The main ingredients of the scheme are as follows: A member country wishing to benefit from the existence of the scheme would enter into an understanding with the international agency administering the scheme with regard to its export projection, the main elements in its development program and the related policies. As long as the administering agency was satisfied that the member country was doing its best to implement these agreed policies and programs, it would be presumed that any shortfall from the export projection was a shortfall outside the country's control and was likely to disrupt the country's development program. The scheme under these circumstances would operate to provide speedy relief to the country affected by an export shortfall. The amount of assistance provided by the scheme would depend on the amount of previously accumulated earnings above expectations (so-called "overages"), the amount of financing available from other sources of finance including the IMF compensatory facility and, finally, the feasible adjustment measures that the country itself could undertake to absorb part of the effects of an export shortfall without disrupting its development program. The extent to which the country would be called upon to use other sources of finance, as well as the nature of the feasible domestic adjustment, would be agreed to in advance with the agency.

The scheme would be administered by an international agency, which might be one already existing or a new one established for the purpose. Supporting member governments would provide resources permitting operations during an initial five-year period. In our study we estimated that a level of $300 million to $400 million per year would probably suffice. Benefits of this scheme would be available to all developing countries prepared to meet the criteria of the scheme. Assistance from the scheme would be on the same terms as basic official development finance, usually quite concessional.

I realize that there are many parts of the scheme on which I might comment. However, within the time available to me, I think it would be more useful if I were to confine myself only to certain aspects of the scheme.

One of our fundamental assumptions in developing the scheme was that any assistance from the scheme should be related to adequate economic performance by developing countries. This principle also helped in coping with the problem of how to judge whether shortfalls were to be considered to be due to causes beyond the country's control. The concept of relating assistance to performance criteria enabled us to use a relationship of fundamental importance in basic development finance and also one that organically linked supplementary finance with normal or basic development finance, since criteria applicable to the latter could be used in whole or in part in providing supplementary finance.

The novelty introduced by our proposed Supplementary Finance Scheme is that the scheme is based on performance criteria to be worked out for all developing countries and in such a way that donor and recipient countries agree on what is feasible and desirable, i.e., worthy of support by the international community. As a consequence, both donors and recipients have a stake in the success of the agreed development programs. The development effort thus becomes truly international, with all countries—donors and recipients—prepared to accept limitations on their freedom of action but within the framework of general policies and procedures which they adapt and change—as needed. The benefit is not only the more efficient use of available development finance, but an alternative way to cope with the difficult relationship problems which arise in this sensitive and important field. This approach evolved for the Supplementary Finance Scheme is clearly applicable to all development finance and has been increasingly so recognized.

The use of agreed performance criteria also helps to meet another important difficulty, namely, the need to make the availability of assistance from the scheme certain and speedy, but still subject to administrative discretion of the agency, i.e., not automatic. A time-consuming examination of the performance of a country *after* a shortfall is avoided in the scheme by stipulating that an understanding be arrived at in advance, at the beginning of a planning period, between the international administering agency and the individual country concerning the development program and related policies. Certainty of assistance is assured by the provision that, as long as the country adhered to this understanding, the country would qualify for assistance in the event of an export shortfall. The international agency would be in continuous contact with the country and the implementation of the agreed program and policies by the country would provide an *a priori* reason to believe that any shortfall was due to causes beyond the country's control. The ingredients of this "policy package," as we call it in our study, would, of course, vary from country to country. Standardized criteria would be avoided; much reliance would be placed on the objectivity and competency of the international agency to agree with the country concerned on a policy package adapted to the conditions of the country, but designed to achieve the objectives of economic development. Moreover, to avoid unrealistic rigidity the international agency and the country could agree at any time to needed changes in policies implementing the development program, but all the time the international community would be assured that its pledged support was for an internationally agreed program and policies.

Another principle on which we based the scheme was that the export projection from which shortfalls would be calculated would be not only as objective and scientific as statistical techniques and available data permitted, but also agreed to between the agency and the country. This projection, extending over the entire period of the development program, would be arrived at in the context of an understanding on the program as a whole. It would be subject to review and revision only in agreement with the international agency and as part of an agreed general recasting of the program.

In suggesting a five-year projection period to coincide with the usual length of a development plan, we were keenly aware of the limitations of available techniques of projection over that long a period. Projections are, however, built into development programs in two ways: the development program contains commitments to

certain policy actions on which the projections are based, especially in export policies; the development program in turn is based on the export projection and is tested for financial feasibility on the basis of anticipated export earnings and other sources of development finance. Many countries are already accustomed to making projections to provide a basis on which investment programs can be built. We felt that a five-year export projection, as against a much shorter time period, was necessary since investment calculations over the plan period must be based on export projections and the length of the latter should by its very nature be tied to the former, namely, investment calculations. In suggesting this we were encouraged as to its feasibility by our own experience in this field. We compared IBRD projections of comparable time lengths with actual historical experience in 37 cases involving 19 countries. We ran a number of statistical tests to judge the reliability of our projections, and on the basis of these came to the conclusion that five-year export projections were feasible and reasonable. The quality of projections can, of course, be improved by sharpening analytical tools and strengthening the basis for technical judgments, and we are planning to do so in the World Bank in any case. This is a field in which improvement in technique can make a big difference to the effectiveness of planning in developing countries. However, if I may state the obvious, the improvement in projection technique will not eliminate the problem of unexpected shortfalls because unpredictable changes in the world economy will continue to take place.

Having decided on a scheme that would provide timely assistance for countries experiencing export shortfalls, the questions of how much finance and on what terms had to be analyzed and answered. We assumed that assistance from the scheme should be adequate to perform the job, but not more than necessary to protect an agreed development program from disruption. This minimum amount should be provided by the donor countries; after analysis, as I said before, we concluded that $300 million to $400 million per year for five years was a reasonable figure for the initial period. However, the recipient LDC should also do what it can to meet a shortfall, without disrupting its development program. Thus we felt that there should be provision in the scheme to apply against the shortfall any "overages" in export earnings accumulated during the plan or projection period. There would also be an understanding on appropriate use of the country's reserves. If these were inadequate, the compensatory financing facility of the IMF might be drawn upon if the country qualified for such assistance under the IMF rules. Other action that the country could take would depend on the circumstances of the country. For example, additional drawing rights in the IMF or other sources of international assistance might be available, or the government might have latitude for the restriction of some luxury imports or revision of tax rates, etc.

The provision that a country should make all feasible domestic adjustments raises many questions. What is to be strictly regarded as the development plan? How about cuts in consumption—are they appropriate when the levels of consumption are already very low? Should provision be made for refinancing drawings from the Fund, if such drawings remain outstanding after five years? Are changes in fiscal policy to absorb part of the effect of an export shortfall to be considered appropriate when there is a possibility that the shortfall may be reversed? We have tried to approach these more detailed questions in the same way as the original broad questions, i.e., as economists trying to find practical solutions based on objective analysis.

There are a number of aspects of the scheme that I have not touched upon, but I hope this presentation helps to provide you with a fair idea of our approach to the questions and issues of development as they arise at an international level. The questions and issues which I have mentioned today do not, of course, exhaust the area of concern to development economists and policymakers in this field. I do hope, however, that they give some indication to those of you outside of governments and international institutions as to our common needs for further research, analysis and theory in this field.

* * *

Many of our problems as economists and economic policymakers are created by the existence of national boundaries, yet we have many more national boundaries than ever before. This gives special importance to international institutions since, for the time being at least, they represent an attempt to reconcile the nation-state and the underlying unity of economic behavior. The international financial institutions thus have a special responsibility; not only are we given a mandate to help solve some of the world's critical problems, but we have been entrusted with large sums of monies by the international community. As economists in these institutions dealing with very difficult problems on the policy frontiers of economic science, we need all the help and guidance we can get in fulfilling our tasks.

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International Problems of Economic Development

I

I have been connected with international institutions for most of my professional career -- namely the Fund and the World Bank Group since their inception -- and I thought it may be of some interest to you if I were to talk today about the economic issues and problems which arise at the international level and which constitute the bulk of my work.

II

Let me sketch in broad outline three major features of the problems that confront economists dealing with problems of development at an international level of action and policy.

First we are engaged in the process whereby the advanced industrial countries have come to the assistance of the LDC's in order to accelerate their development. This process whereby one group of nations has recognized an obligation to help accelerate the economic development of another group of nations has become so familiar a feature of our daily newspaper reading that we sometimes forget what a profound new development this is in human affairs. Professional historians have noted this fact and have suggested that this development may well be the most distinguishing feature of our age.

This development has, at the same time, raised a number of questions with regard to the nature of international economic relationships which go far beyond the confines of the existing theory of international trade and finance. For the present, let me pick out just two questions which are of very particular interest to us as economists in the World Bank Group. The first is the question of burden sharing -- on what principles is the quantum of aid to be divided among the aid givers.

At present a great deal of aid effort is organized bilaterally, and historically it has been dominated by a variety of political factors. A part of the aid is, however, through multilateral channels, and of late an increasing part of bilateral aid has come to be organized on an international basis through various coordinating mechanisms such as consortia and consultative groups. We have been involved in this since most of these coordinating mechanisms have been devised under the aegis of the World Bank. One of our concerns here has been to increase the role of economic calculus in the search for criteria by which the international aid effort can be shared among the donor countries. This is not easy, and as recent discussions have shown, there are even problems in measuring the burden to the donor countries of the assistance they provide. This assistance is provided under such different terms and under so many constraints on its use by the recipient countries that a comparison of the nominal amounts is clearly not adequate as indicating the relative burden borne by these countries.

Various approaches have been made to this problem of burden sharing; there are for example, various proposals to link the total aid provided by each individual donor country to some percentage of national income. Then there is the approach which has related the amount of official aid to the budgetary situation in each country. Another important economic factor that has played a role in this question is the balance of payments effect of aid. Flows of aid, representing a transfer of resources overseas, enter the balance of payments of a donor country as an extraneous element not directly related to the economic activities of consumption and production. A transfer of resources overseas without a corresponding matching in terms of aid-financed commodity exports may alter the relative balance of payments situation of countries.

This kind of concern with the balance of payments has been an important reason -- though by no means the only one -- behind tying of bilateral aid to procurement in the country providing funds. But on the other side of the picture, the use of such tied aid creates some problems for the recipient countries. The inefficiencies associated with aid tying principally in terms of the higher prices the LDC's have to pay for their aid-financed purchases, have been widely discussed elsewhere by professional economists and by developing countries in various international forums. Estimates made indicate that tying results in about 15 per cent increase in prices of commodities financed by aid; for some individual countries the percentage is even higher. The inefficiencies in international competition which tying introduces has weighed so heavily that the Bank and the International Development Association (IDA) in their operations have insisted on international bidding in the use of funds. The economic question in this is how to reconcile the advantages of international competitive bidding from the viewpoint of developing countries with the consideration of the balance of payments effects of such a procedure on industrial countries in balance of payments difficulties. Or to put it another way, the question of economic interest is not how to take aid out of balance of payments but rather how to take the balance of payments out of aid. The answer for some is that the magnitude of development assistance should not be related to balance of payments positions; any disequilibrating payments effects should be offset by available equilibrating measures. The problem should be thought of purely in resources terms. This issue of the relation between assistance and balance of payments is now of critical importance in current negotiations on various proposals on development finance.

While these are some of the problems on the side of burden-sharing by the rich nations, there are equally complex problems in the flow of aid to the developing countries. Among these problems are the amounts of assistance to be given to particular developing countries; the purposes for which such assistance is given -- for specific projects, for general import financing, for budgetary support, etc; the relative amounts of grants and loans; the terms and maturities of loans; the relation between debt servicing and net flow of assistance, etc. Each of these problems raises a host of others. If I may, I will comment today only on the problems of aid allocation.

The total volume of aid today is not adequate to provide all the funds which the developing countries could productively use for their development, hence the need for some criteria by which aid can be allocated. So far political considerations have dominated the allocation of bilateral aid as shown for example, by the extent to which aid from particular countries is largely concentrated to particular regions -- French aid to franc area, British aid to former Empire, U.S. aid to Latin America -- and this has brought to the forefront of aid discussions the question whether and what economic criteria are at all applicable in this field. The obvious criterion of relative poverty as a principle of allocation of aid is not entirely satisfactory from the point of view of ensuring that development assistance is put to the most productive use. To ensure the effective use of aid, therefore, there is today increasingly a search for some sort of, what has come to be known in the jargon as, performance criteria which would relate aid to economic performance by developing countries.

There is as yet no clear agreement among economists on what criteria should be appropriately applied in judging performance -- nor indeed on the precise meaning of the concept itself. What interpretation to give to this concept -- is "performance" the same thing as creditworthiness of a country in terms of its ability to service more loans? Should it be judged in relation to the extent to which countries attain the targets of their development plans? Or is it its adherence to what might be considered "right" policies irrespective of the results obtained? Or should it be identified with the degree of success which a country has achieved in its economic affairs, irrespective of the amount of aid it has received, and irrespective of the favorable or unfavorable accidents which have attended its domestic activities or its foreign trade and other relationships?

There are no clear answers to the question of evaluating performance in developing countries either in theory or in practice. Economic science has been traditionally concerned with questions of efficiency and welfare which one one might have thought would provide us with some criteria of evaluating performance. But we do not get much help here. On the one hand we have elegant models which rarely get out of algebra into arithmetic using reliable numbers; on the other hand we have the rule of thumb approach, i.e. some universal formula based on some simple relationships. For example, a formula which would measure performance in terms of the increase in government capital formation as a proportion of GNP over the past few years. Then, there is the notion of various "correct" policies that should be followed to maximize economic welfare, with which economic science has been grappling ever since its birth -- the use of the price mechanism and competition, the encouragement of investment and innovation, the promotion of foreign trade, etc., but the problem of formulating them in such a way as to take account of the great variety of circumstances found in the developing countries still remains largely unsolved.

In practice, it has been customary to consider the performance of developing countries by the rate of growth of its national income in the past as well as the rate of growth likely in the future. Judgments on likely future rates of growth are arrived at on the basis of judgments on whether a country is having a satisfactory amount of savings and investment, whether it is allocating its resources properly, whether it is having a proper monetary policy, whether it is maintaining the right rate and so on. It has been a mixture of objective criteria and subjective judgments.

The use of the national aggregates, especially the rate of growth of national income, as a guide to performance is not entirely satisfactory, *per se*, since the efforts which the poor countries have to make to promote their own development is not necessarily reflected in the growth of their national incomes in the short period. These countries are interested in economic development because they want to achieve higher living standards ultimately, but the pattern of investment that they choose to achieve this may offer little immediate returns. For example it is now more and more widely recognized that the developing countries must first achieve a basic structural transformation of their economies, particularly in order to harness modern science and technology to their production systems. An essential aspect of such a transformation is the building up of a sufficient amount of physical and social infrastructure, even at times, ahead of the demand for such facilities. The real justification for these investments is not that they by themselves would lead in the short run to growth of the national incomes of these countries, but that they will eventually increase the returns to directly productive investments.

Let me illustrate the way in which national aggregates can hide the extent of progress made in the field of development with the example of India. Over India's first three plan periods covering the 15 years 1950 to 1965, the national output in India increased at a little more than 3 per cent per year and per capita output by over 1 per cent per year. This is quite modest, and may even be disquieting, but at the same time between 1950 and 1963 installed electricity capacity increased 230 per cent, 93 per cent of the number of towns and villages counted in the 1961 census were electrified by 1966; railway goods traffic increased by 142 per cent; railway passenger traffic by 33 per cent; number of doctors by 39 per cent; literacy rate increased from 16.6 per cent in 1951 to 24.0 per cent in 1961; enrollment ratio for primary education increased from 43 per cent in 1951 to 67 per cent in 1961, and so on. Are these not the sort of changes that are necessary for a country's development, in whatever way development as a process of modernization may be defined?

It is for this sort of reason that I have increasingly felt that in judging performance, we should try and get away from simplistic notions of national income growth. All major aspects of the economy need to be considered. In judging performance we should also look to the efficient implementation of projects within an over-all development strategy, and the contribution a country itself makes to the financing of these projects (depending on its capacity). Within the Bank we are still debating the

issues of how to judge performance as I am sure some of you are too. We have no dogma on the subject nor do we want to give undue weight to the past. Instead, we have often used what might be called the "policy approach" whereby we agree with member developing countries on certain policies they should follow in the future calculated to promote their best feasible development, e.g., monetary and fiscal policies designed to accelerate resource mobilization, incentive taxation, forward planning of investments, etc. Agreement on these policies is arrived at through a continuous process of consultations, and as long as the country implements these policies, its performance is judged adequate for purposes of future assistance from the Bank Group. In some cases, even this approach is not feasible, and the problem of judging performance for the purpose of Bank lending becomes quite perplexing. One such case is that of a country which has no record of good past performance, and no commitment to future policy actions which would give adequate priority to development and which could be agreed internationally. At the same time this is a country with vast reserves of an important mineral resource with a high and increasing export demand, which it wishes to develop with the help of an international project loan. What should the Bank do? Should it accept the argument that a successful exploitation of this mineral resource is vital enough for the future economic development of the country for it not to bother with the general governmental economic policy? Or should it wait for improvement in government policies for development before agreeing to lend with the expectation that the country's eagerness to obtain financing for such an attractive project will help induce the country to adopt better economic policies? Fortunately these situations are exceptional but they do illustrate some of the knottier problems which may arise in evaluating performance.

The Bank's interest in the economic performance of the developing countries in recent years goes far beyond its own immediate lending operational needs. For example, it has now become an important part of its increasing role in the coordination of aid including bilateral sources, to the developing countries, especially in the form of consultative groups. One of the important functions that the Bank assumes in agreeing to organize a consultative group for any country is to make periodic comprehensive economic reports on the country's development possibilities, problems and performance as a basis for the group's deliberations. There are now 12 developing countries which are covered by consultative groups or consortium arrangements chaired by the World Bank. In addition to these, for our own purposes we undertake economic reviews evaluating performance of our member developing countries -- in all last year we made such reviews for 45 countries; and since March 1965 for 73 countries. As a part of these responsibilities, we are continuously in search for more explicit performance criteria which can be applied consistently among the less developed countries.

This whole question of performance brings me to the second group of problems of development, namely the role of economics in the practical task which the developing countries face in promoting their own development with their own resources and with external assistance.

The task ahead of the developing countries, as has been often pointed out, remains a long and arduous one. They still have to make an enormous effort to raise their economies to a level where they can exploit modern science and technology, their main hope for rapid progress in a world where the other countries are advancing so fast already. For this purpose, the developing countries have to bear heavy sacrifices of present consumption, already at a pitifully low level, in order to make investments for the more or less distant future. A myriad of problems confront their leaders in the painful choices they have to make, between consumption and investment, between quick returns and long-run goals, between social stability and economic growth, etc. They bring only limited experience to this unfamiliar task. There are inescapable political factors in the decisions actually made by their governments. In the face of all these difficulties, we have to find methods of evaluating the priority given to development, which would recognize the political element in decision-making, and yet be economic and objective enough to escape narrow political bias.

The process whereby policy decisions are translated into concerted public action and private response is necessarily slow and it is not surprising, therefore, that some of us are at times discouraged by the pace of development in the developing countries. It is still a fashionable exercise to predict a gloomy future for them in terms of an ever-widening gap between them and the advanced countries by projecting rates of growth observed in the recent past. GNP per capita in developing countries (excluding Sino-Soviet countries) for which we have data has been growing at the rate of 1.8 per cent per year over the period 1960-65. The rate of growth of GNP per capita in the United States and Germany has been, on the other hand, 3.2 per cent and 3.5 per cent respectively. If the per capita income of these countries were to be extrapolated on the basis of past trends, in 1980, the per capita income of LDC's, which now stands at around $150 per year, would still be only $195. For particular regions and countries especially those of Soudh Asia, prospects on the basis of a simple extrapolation would be even bleaker. As against this, per capita income in the United States would have increased to $5,060 per year from the present level of $3,160; and in Germany from $1,590 to $2,650.

I, for one, do not share in this pessimism, for progress is being made and must continue to be made at an ever-increasing pace. By its very nature, economic development is not a simple extrapolation of steady rates of growth; it is a deliberate attempt to accelerate and change existing trends. There are increasing signs that the investments of the past decade and those of the next will make a decisive change from the past stagnation, which, in many cases, goes back to the 1920's or earlier. What is perhaps less apparent is the great improvement that has taken place in the way the less-developed countries are organizing their development efforts by the use of planning

techniques. On a recent count, at least 50 countries have adopted partial or comprehensive development programs. Some of this planning has been faulty and, at times, even useless. But behind these weaknesses lies a truly remarkable phenomenon -- the acceptance of the planning technique. By planning technique in this context, I do not mean a detailed control and regulation of economic activity. Rather, it is the method by which governments make commitments to future actions and policies, thus extending the time horizons within which economic calculations based on objective criteria can play a greater part. The planning technique then becomes an important instrument for coordinating development activity on a number of different fronts, and for maintaining some sort of continuity in the pace of development. Seen in such a broad perspective, the progress that has been made is considerable, and what is needed now is to push further the basic planning ingredient of commitment to future action on a coordinated basis, consistent with the possibilities of practical implementation. While the improvements in the use of the planning technique promise to make the development efforts of less-developed countries more successful in achieving their goal, it also provides a convenient framework by which the international community can make an over-all evaluation of the development program and priorities, and at the same time a focus towards which international development assistance can be directed.

A third important feature of the economic problems that we have to deal with is to find ways in which we can assist the developing countries in the mobilization of resources for their development. There are a number of ways in which they can raise and utilize more of their own domestic resources for this purpose but a particularly stringent constraint for most of the developing countries is in their foreign exchange earnings and receipts. To these countries the means to pay for foreign goods and services are crucial because they must rely on imports for the capital goods which they cannot produce themselves at their lower level of technological development. However, the developing countries generally face serious structural difficulties in transforming their domestic resources into foreign exchange under present conditions of world trade. The difficulties which the developing countries face in commodity trade has been the subject of extended discussions and negotiations between the advanced countries and the LDC's in the UNCTAD, GATT and elsewhere. The other source of foreign exchange for the LDC's is the flows of official and private capital from advanced countries. This, of course, is of very immediate interest to us in the Bank, and there are very many economic questions which arise in dealing with the appropriate terms, level and nature of such assistance, but I would mention only one of these, namely the concept of external capital requirements of developing countries. The concept of capital requirements is an indication of the total amounts that less-developed countries can productively use for their development and as such is one of the factors that the donor countries have to take into account in their decisions about the scale of their assistance to the developing countries. In recent years attempts have been made in the World Bank, the United Nations, the U.S. Government and elsewhere, to estimate the external finance needs of the less-developed countries. The methodology by which these estimates are arrived at differ considerably. The approach we took was based on individual country experience. Considered judgments were made by our country economic staff regarding feasible growth in income, investment and savings, imports and exports for each country taken individually. Our analysis

showed that the developing countries as a whole could effectively absorb over the next five years an additional capital inflow of $3-$4 billion per year. Notwithstanding the informational gap in such estimates, these projections do indicate that even with relatively optimistic assumptions about the growth of exports and effective mobilization of savings as compared to historical trends, there is likely to be for some time to come an increasing requirement for net foreign exchange resources, if these countries are to sustain rates of growth which are compatible with their capabilities.

III

All these three features, that I have described, of coping with the economic problems of development at an international level, find a place in one of the exercises we began in 1965. This is the preparation and international consideration of the Study on Supplementary Financial Measures that we did in response to a request from the United Nations Conference on Trade and Development in 1964. This was a study aimed at devising a way of assisting the LDC's to meet the problem of unexpected export shortfalls which threatened to disrupt their development program, and which were of a nature and duration which could not be met by short or medium-term balance of payments support. We aimed at producing a viable scheme based on economic research and analysis.

The first question we asked ourselves in undertaking the study was whether there was a problem and if so, how big the problem was. The instability in the international trade in primary goods, which constitute the bulk of the exports of the LDC's has been recognized for some time. The notion of instability is quite complex and cannot be completely captured in any simple statistical index. It is only too easy to devise a statistical measurement, call it an "index of instability", and then practically define instability as that which is measured by such an index. Several such indices have appeared in recent years, on the basis of which some authors have even questioned whether there is a problem arising from export instability in the LDC's. Our own studies have persuaded us that export instability is particularly important in the case of primary goods and is a serious problem for the LDC's -- much more serious than for the developed countries. Moreover, this question of instability had been studied in some detail by the IMF staff in providing the intellectual basis for the IMF compensatory financing scheme. This facility, as you know, came into existence in 1963 with the purpose of assisting "members, particularly primary exporters, encountering payment difficulties produced by temporary export shortfalls." The Fund has defined the "norm" as a moving average for five years centered on the current shortfall year so that there would be a rough balancing of shortfalls and surpluses over a reasonable period of time. The assistance provided under the facility is within the framework of normal Fund operations -- to be repaid in three to five years (thus maintaining the revolving character of the Fund's resources).

There is, however, another aspect of the problem of instability which is not dealt with by the Fund Compensatory Scheme nor covered by the usual discussion of instability, namely deviation in export earnings from anticipated earnings on the basis of which a program for development over medium term periods of about five years has been based. These deviations are not measured from extrapolations of past trends but rather from estimates of future expectations. A key aim of development is often to bring about by deliberate policy measures a change in past trends in export performance. This kind of instability with the consequent uncertainty could not be measured by moving averages or similar measures nor dealt with by short-term balance of payments support.

Having isolated the nature of the problem, to which the UNCTAD resolution addressed itself, we next tried to estimate the size of the problem. We wished to test empirically whether the "adverse movement in export proceeds" (and which was defined in the resolution as "a shortfall from reasonable expectations") had been a major problem. In keeping with the logic of the resolution, we defined reasonable expectations as estimated future export eventualities incorporated in an objective export projection within the context of a development program. Establishing the size of the problem involved relating "actuals" to "expectations", and we had to know not only what had happened in the past but also what people expected to heppen at any particular point in the past. Furthermore, we had to be confident that what was done in the past was reasonably objective and could be used as a basis for judging the reliability of the export projections which had been made. It was impossible to have the precise kind of data to conduct the exercise, since our concept was a new one. Fortunately, however, we had an available body of experience within the Bank which could be used. As part of the process of determining the creditworthiness of prospective borrowers and their economic positions and prospects of development, the Bank in a considerable number of cases had projected exports of developing countries for a period of years ahead. Some of these projections had been made entirely by the Bank staff, some had been made originally by technicians in the member countries and modified by Bank economists or accepted by them after analysis, as reasonable. We decided to use these projections made in the past as raw materials for developing the "expectations" side of our analysis, and to compare with them the export performance of the same countries on the basis of available trade statistics. An examination of Bank reports yielded 113 quantitative projections made by Bank economists for 37 countries during the years 1949-64 inclusive, covering projections extending for various periods of time, but typically five years, into the future. Where these projections overlapped for any country, they were combined together into a "composite projection"; this was used as a measure of "reasonable expectations" for comparison with actual export performance. We then measured each country's actual export earnings against the projected values to derive a series of country-by-country, year-by-year shortfalls and, what we called "overages" -- earnings above expectations. This analysis demonstrated that shortfalls below expectations had been significant for a number of countries though the number of countries affected and the intensity of shortfalls varied from year to year.

However, this analysis had an important limitation in that the number of countries in the sample varied considerably from year to year. We, therefore, decided to extract from the list of countries for which composite projections were possible two sample groups, one consisting of fourteen countries for the seven-year period 1957-63 and another of eighteen countries for 1959-63. (The first sample comprised Brazil, Burma, Colombia, Costa Rica, Ecuador, El Salvador, Ethiopia, Guatemala, Mexico, Nicaragua, Pakistan, Peru, Thailand and Sudan. The second sample comprised all of these plus Argentina, Panama, India and Tanganyika (now Tanzania).) When the results obtained on the basis of the two samples were extrapolated to a global basis, this exercise yielded an estimate of $1.6 billion per year of total gross shortfalls, i.e., without subtracting the "overages" earned by the same countries. (Incidentally, export projections are now being done in the Bank for nearly all countries, unless statistically impossible.)

The next question that we tackled was the causes and effects of export shortfalls. We again took the empirical approach and made a number of special case studies of country experience. We reconstructed the economic experience of these countries as best we could. We had the help of economists with rich experience on these countries and of our past economic reports based on field investigations and policy memoranda on countries as well as the published literature. We found that in a number of cases, an unexpected export shortfall had in fact resulted in slowing down, and even halting, of planned investment, and had led to hastily mounted import restriction programs which impeded efficiency, particularly in the industrial sector, as well as emergency cutbacks in private and public investment through monetary and fiscal policies. The axe has usually fallen on long-term, but basic, investments resulting in a loss of momentum in the development effort. In a number of these cases, the export shortfall was due largely to unexpected movements in supply and demand conditions abroad over which the affected country had no control. To illustrate, let me give you an example -- that of Colombia in the early 1960's. In Colombia there has been a significant shortfall in exports below the plan target made in 1961, largely because of the fall in coffee exports in the 1960's. Though some decline in coffee prices had been expected, the extent of that decline could not have been anticipated on any reasonable basis. The most immediate effect of the shortfall in export earnings was in the slowing down of the rate of growth of industrial output. The rate of capital formation in Colombia is heavily dependent on the flow of imported machinery and equipment which increased by some 20 per cent in 1960 and 7 per cent in 1961, but declined by 13 per cent in 1962 and 19 per cent in 1963. Actual investment expenditures of the national government in 1963 were less than two-thirds of the target established under their plan which had been received by the World Bank staff. The major victim of the government retrenchment was transport investment.

Thus, we concluded on the basis of past experience that the problem of unexpected export shortfalls was a real one for many developing countries and that this constituted a serious danger to the process of planned development in these countries. A new scheme was therefore needed to meet this problem. The scheme we proposed is now being discussed by an expert group of governmental representatives consisting of 14 developed and developing countries set up by the Trade and Development Board of the United Nations.

The main ingredients of the scheme are as follows: a member country wishing to benefit from the existence of the scheme would enter into an understanding with the international agency administering the scheme with regard to its export projection, the main elements in its development program and the related policies. As long as the administering agency was satisfied that the member country was doing its best to implement these agreed policies and programs, it would be presumed that any shortfall from the export projection was a shortfall outside the country's control and was likely to disrupt the country's development program. The scheme under these circumstances would operate to provide speedy relief to the country affected by an export shortfall. The amount of assistance provided by the scheme would depend on the amount of previously accumulated earnings above expectations (so-called "overages"), the amount of financing available from other sources of finance including the IMF compensatory facility and finally,

the feasible adjustment measures that the country itself could undertake to absorb part of the effects of an export shortfall without disrupting its development program. The extent to which the country would be called upon to use other sources of finance as well as the nature of the feasible domestic adjustment would be agreed to in advance with the agency.

The scheme would be administered by an international agency, which might be one already existing or a new one established for the purpose. Supporting member governments would provide resources permitting operations during an initial five-year period. In our study we estimated that a level of $300 million to $400 million per year would probably suffice. Benefits of these schemes would be available to all developing countries prepared to meet the criteria of the scheme. Assistance from the scheme would be on the same terms as basic official development finance, usually quite concessional.

I realize that there are many parts of the scheme on which I might comment. However, within the time available to me, I think it would be more useful if I were to confine myself only to certain aspects of the scheme.

One of our fundamental assumptions in developing the scheme was that any assistance from the scheme should be related to adequate economic performance by developing countries. This principle also helped in coping with the problem of how to judge whether shortfalls were to be considered to be due to causes beyond the country's control. The concept of relating assistance to performance criteria enabled us to use a relationship of fundamental importance in basic development finance and also one that organically linked supplementary finance with normal or basic development finance since criteria applicable to the latter could be used in whole or in part in providing supplementary finance.

The novelty introduced by our proposed Supplementary Finance Scheme is that the Scheme is based on performance criteria to be worked out for all developing countries and in such a way that donor and recipient countries agree on what is feasible and desirable, i.e., worthy of support by the international community. As a consequence, both donors and recipients have a stake in the success of the agreed development programs. The development effort thus becomes truly international with all countries -- donors and recipients -- prepared to accept limitations on their freedom of action but within the framework of general policies and procedures which they adapt and they change, as needed. The benefit is not only the more efficient use of available development finance, but an alternative way to cope with the difficult relationship problems which arise in this sensitive and important field. This approach evolved for the Supplementary Finance Scheme is clearly applicable to all development finance and has been increasingly so recognized.

The use of agreed performance criteria also helps to meet another important difficulty, namely, the need to make the availability of assistance from the Scheme certain and speedy, but still subject to administrative discretion of the agency, i.e., not automatic. A time-consuming examination of the performance of a country after a shortfall is avoided in the scheme by stipulating that an understanding be arrived at in advance at the beginning of a planning period between the international administering agency and the individual country concerning the development

program and related policies. Certainty of assistance is assured by the provision that as long as the country adhered to this understanding, the country would qualify for assistance in the event of an export shortfall. The international agency would be in continuous contact with the country and the implementation of the agreed program and policies by the country would provide an a priori reason to believe that any shortfall was due to causes beyond the country's control. The ingredients of this "policy package" as we call it in our Study would, of course, vary from country to country. Standardized criteria would be avoided; much reliance would be placed on the objectivity and competency of the international agency to agree with the country concerned on a policy package adapted to the conditions of the country but designed to achieve the objectives of economic development. Moreover, to avoid unrealistic rigidity the international agency and the country could agree at any time to needed changes in policies implementing the development program, but all the time the international community would be assured that its pledged support was for an internationally agreed program and policies.

Another principle on which we based the scheme was that the export projection from which shortfalls would be calculated would be not only as objective and scientific as statistical techniques and available data permitted, but also agreed to between the agency and the country. This projection, extending over the entire period of the development program, would be arrived at in the context of an understanding on the program as a whole. It would be subject to review and revision only in agreement with the international agency and as part of an agreed general recasting of the program.

In suggesting a five-year projection period to coincide with the usual length of a development plan, we were keenly aware of the limitations of available techniques of projection over that long a period. Projections are, however, built into development programs in two ways: the development program contains commitments to certain policy actions on which the projections are based, especially in export policies; the development program in turn is based on the export projection and is tested for financial feasibility on the basis of anticipated export earnings and other sources of development finance. Many countries are already accustomed to making projections to provide a basis on which investment programs can be built. We felt that a five-year export projection as against a much shorter time period, was necessary since investment calculations over the plan period must be based on export projections and the length of the latter should by its very nature be tied to the former, namely investment calculations. In suggesting this we were encouraged as to its feasibility by our own experience in this field. We compared IBRD projections of comparable time lengths with actual historical experience in 37 cases involving 19 countries. We ran a number of statistical tests to judge the reliability of our projections, and on the basis of these came to the conclusions that five-year export projections were feasible and reasonable. The quality of projections can, of course, be improved by sharpening analytical tools and strengthening the basis for technical judgments, and we are planning to do so in the World Bank in any case. This is a field in which improvement in technique can make a big difference to the effectiveness of planning in developing countries. However, if I may state the obvious, the improvement in projection technique will

not eliminate the problem of unexpected shortfalls because unpredictable changes in the world economy will continue to take place.

Having decided on a scheme that would provide timely assistance for countries experiencing export shortfalls, the questions of how much finance and on what terms had to be analyzed and answered. We assumed that assistance from the scheme should be adequate to perform the job but not more than necessary to protect an agreed development program from disruption. This minimum amount should be provided by the donor countries; after analysis, as I said before, we concluded that $300-$400 million per year for five years was a reasonable figure for the initial period. (We have explained in other forums in some detail how we arrived at this figure.) However, the recipient LDC should also do what it can to meet a shortfall, without disrupting its development program. Thus we felt that there should be provision in the scheme to apply against the shortfall any "overages" in export earnings accumulated during the plan or projection period. There would also be an understanding on appropriate use of the country's reserves. If these were inadequate the compensatory financing facility of the IMF might be drawn upon if the country qualified for such assistance under the IMF rules. Other action that the country could take would depend on the circumstances of the country. For example, additional drawing rights in the IMF or other sources of international assistance might be available, or the government might have latitude for the restriction of some luxury imports or revision of tax rates, etc.

The provision that a country should make all feasible domestic adjustments raises many questions. What is to be strictly regarded as the development plan? How about cuts in consumption -- are they appropriate when the levels of consumption are already very low? Should provision be made for refinancing drawings from the Fund, if such drawings remain outstanding after five years? Are changes in fiscal policy to absorb part of the effect of an export shortfall to be considered appropriate when there is a possibility that the shortfall may be reversed? We have tried to approach these more detailed questions in the same way as the original broad questions, i.e. as economists trying to find practical solutions based on objective analysis.

There are a number of aspects of the scheme that I have not touched upon, but I hope this presentation helps to provide you with a fair idea of our approach to the questions and issues of development as they arise at an international level. The questions and issues which I have mentioned today do not, of course, exhaust the area of concern to development economists and policy-makers in this field. I do hope, however, that they give some indication to those of you outside of governments and international institutions as to our common needs for further research, analysis and theory in this field.

Many of our problems as economists and economic policy-makers are created by the existence of national boundaries, yet we have many more national boundaries than ever before. This gives special importance to international institutions since for the time being at least, they represent an attempt to reconcile the nation-state and the underlying unity of economic behavior. The international financial institutions thus have a special responsibility; not only are we given a mandate to help solve some of the world's critical problems, but we have been entrusted with large sums of monies by the international community. As economists in these institutions dealing with very difficult problems on the policy frontiers of economic science, we need all the help and guidance we can get in fulfilling our tasks.

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Statement by
Irving S. Friedman
The Economic Adviser to the President
to the
U.N. Economic and Social Council
Geneva, July 13, 1967

Mr. President,

I am very happy to have this opportunity to address, for the first time, the summer session of the Economic and Social Council, and have listened with great interest to the statements which have been made thus far.

In December 1966 Mr. George Woods, the President of the World Bank Group, reported to the Council on the activities of the international institutions in the Group, namely the World Bank, the International Development Association and the International Finance Corporation. In his report he described not only the activities of these institutions, but also some of the requirements of international development finance and drew attention to the wider spectrum of world efforts in this field. He also suggested, as you may recall, that the time had come for the industrial countries to make a joint and thorough examination on the highest political level of what they are trying to achieve and are prepared to do in their relationship with the developing world. At this time I would like to present our assessment of the economic situation of developing countries and mention some aspects of what we are trying to do to fulfill our international responsibilities.

The central preoccupation of the World Bank Group is the economic development of the less developed countries. More particularly, our concern is to find ways and means of providing the necessary external capital to supplement the resources of the developing countries and to ensure that whatever resources are available are used effectively to increase productive capabilities and efficiency. Our responsibilities naturally lead us to follow closely economic developments in the industrialized countries, for their private investors and governments are the principal sources of the additional finance required by the poorer countries as well as their major export markets.

I will not review in detail, as Mr. Schweitzer has done and others will undoubtedly also do in these deliberations of the Council, the current trends and outlook in the industrial countries beyond noting that several factors in these countries - the persistent concern with balance of payments problems in some of these, the budgetary difficulties, the existence of a business slowdown in some, concern over inflationary pressures in others, a pervasive large demand for resources for major public expenditure programs, steps in economic integration - all combine to make uncertain both the markets for the exports of the developing countries and the availability of external capital for these poorer countries. These uncertainties must be kept in mind when approaching the particular problems of the encouragement of development in developing countries.

The record of the Development Decade has in many respects been disquieting so far, although the annual average rate of growth in production of the developing countries as a whole since 1960 has been close to 5 per cent. Thus, the record has fallen only slightly short of the U.N. Development Decade target. However, there has simultaneously been an increase in the already high rate of population growth. Population growth in the developing countries increased from a rate of 2.1% in the 1950s to 2.4% through the first half of the 1960s. This has meant that the growth of per capita income has been only 2.3% per year and the average per capita income in the developing countries is only about $150 per year. Unless there is a marked improvement in the rate of growth of income or a decline in rate of increase of population, the future promises little change from the present situation.

Furthermore, the average income growth rate of 2.3% per capita for developing countries as a whole conceals substantially lower rates in certain areas of the world. South Asia has had a per capita growth rate of less than 1% in 1960-1965, Africa only 1.4%, Latin America only 1.7%. On the other hand, some areas of the world, namely the Middle East and the developing countries of Southern Europe, achieved considerably more than the average, while East Asia has grown at the average rate for all developing countries. We sometimes tend to overlook the fact that a number of less developed countries all over the world are demonstrating that relatively high rates of growth in the magnitudes of 7% per annum, and at times even higher, can be achieved. The Republic of China, Greece, Israel, Ivory Coast, Korea, Mexico, Thailand, Yugoslavia, and others, are evidence of the fact that countries in all regions with greatly differing domestic resources and conditions can achieve much more satisfactory growth rates than prevails on average.

The experience of the developing countries indicates that those countries which have emphasized the promotion of exports both in magnitude and diversification have by and large done much better in achieving higher growth rates than other countries. However viewed, either as incentive to the use of improved technology and business practices, or the need to pursue domestic policies most conducive to growth, or sources of increased public revenues, or possibilities of improving savings habits and institutions, or generation of new investments in other fields, or decreased vulnerability to developments abroad, etc., the export behavior can be of decisive importance in the development process. Moreover, developing countries must rely on merchandise export earnings for most of their foreign exchange needs - at present exports finance 80% of their payments abroad.

The merchandise exports of developing countries have increased at the rate of 6% to 6.5% per year since 1960. World exports of manufactures on the other hand, have risen at about a rate of 9.5% per year. As expected there have been considerable fluctuations in export prices in the 1960s, but with virtually no change in the average. On the other hand, the average prices of manufactures have risen somewhat. Although on average this has meant a small movement in the terms of trade against the developing countries, significant conclusions about terms of trade must really be made on a country-by-country basis, and the experience has been very varied.

The average rise in export earnings of the developing countries masks great diversity among them. On a regional basis, the Middle East increased exports between 1960 and 1965 at a rate of 8%, mainly because of petroleum. Africa increased exports at 9% due mainly to strong growth in exports of petroleum in Algeria and Libya and copper in Zambia. In East Asia (other than Indonesia) the increase was over 10% and was probably more attributable to the pursuit of appropriate domestic policies than to the particular commodity compositions of exports. In 1966 export growth of Latin America and Africa was fairly satisfactory, largely because of buoyancy in the grain, cocoa, and copper markets and expansion in the volume of coffee and meat exports. South Asia, where much of the population of the developing world is concentrated, continued to lag behind.

The flows of capital from the developed to the developing countries did not change much in 1966 from previous years. The official net capital flow in 1966 to developing countries and multilateral institutions probably was slightly higher for the members of the OECD's Development Assistance Committee than the level of about $6 billion which has prevailed since the beginning of the 1960s. Private capital net of amortization in 1966 amounted to less than $3.4 billion, lower than the level reached of nearly $4 billion in 1965. Aside from the flow of private investment to the oil and metal producing countries, private capital exports in 1966 to the LDC's amounted to somewhat over $2 billion.

At the same time external public and publicly guaranteed debt of the developing countries has continued to rise. It amounted to more than $41 billion by mid-1966 and debt service on public and publicly-guaranteed debt alone was close to $4 billion during that year. The outstanding debt has been increasing at an annual rate of about 16% during recent years and the annual debt service has been increasing at a rate of about 10%. Of course, some countries have been increasing their debt at an even faster annual rate. At the same time the ability of developing countries to absorb capital efficiently has increased markedly because of the accumulated experience of the past and administrative improvements. Thus, while the sources of foreign exchange have tended to remain stable or increase only modestly, the need for foreign exchange to service debt and to pay for imports necessary for development has risen markedly.

The rising debt problem has tended to draw increasing international attention to the question of terms of official assistance. A steady decline in the grant component of official assistance - from 76% of the total in 1961 to 65% in 1965 - was fortunately reversed in aid commitments approved in 1966. Similarly, there was some reversal in loan commitments of 1966 of the hardening of terms that occurred in 1965. The Development Assistance Committee has addressed itself to this problem and has recommended terms which are still more concessionary than those now prevailing. In the World Bank Group concern with this problem is reflected in the proposals now being considered for a large increase in the resources of the International Development Association - commonly referred to as the IDA - which provides development credits on concessional terms as well as by recommendations made in consultative groups and other similar bodies. I must express my appreciation for the constructive remarks made by a number of speakers about the replenishment of IDA.

Thus it is probably safe to conclude that the shortfall between the ability of the less developed countries to use capital effectively to increase output and their ability to raise adequate resources is becoming larger. This conclusion has been borne out by a recent World Bank staff review in which we re-examined on a country-by-country basis the evidence for our previous conclusion that the developing countries could use effectively $3-$4 billion more per year in external capital during the next five years; our new studies affirmed our previous conclusion. Our experience also indicates that the ability to obtain larger flows of capital is intimately related to the efforts being made by the developing countries themselves to accelerate their growth. The prospects for achieving needed increases in flows of private or official capital are much dimmer in countries which do not have the political stability necessary to carry out productive investment programs and which are not able to point to a reasonably satisfactory record of achievement both in domestic resource mobilization and in the pursuit of domestic policies designed to achieve the efficient use of available resources. There is already an impressive record of accomplishment in many cases of an effective mobilization of national resources. In fact, it is sometimes overlooked that only a minor part of investment in the developing countries is financed from abroad. Indeed, on average probably more than 80% of investment in developing countries is being financed out of their own savings.

There is, of course, much room for improvement and in some fields the need for improvement is urgent. It is probably safe to say that the problem of agriculture and food is of serious concern to all countries and international institutions participating in this debate; this concern has been expressed by the Secretary General and other previous speakers. Performance in agriculture is lagging badly in a number of countries. Speaking generally, it has failed to keep pace with population growth. In South Asia in particular, agricultural output per capita has declined. For many years agriculture will continue to be the dominant sector in most developing countries and the growing gap between food production and requirements must be tackled successfully. Several of the developing countries themselves are taking measures to increase investment in food production. India, for example, has strengthened her efforts in this direction.

Although I do not intend to report in this statement in any systematic way on the World Bank Group operations, I thought it would be useful to give you a brief account of what we are doing in agriculture because of the worldwide concern with this problem.

Starting in the early 1960s, the World Bank Group adopted a policy of devoting its loans and credits increasingly toward the development of agricultural production. This policy is gaining ever greater momentum. A total of ten agricultural projects involving Bank or IDA assistance of $87 million was approved during the fiscal year 1966-67 just ended. This raised the aggregate amount of finance provided by the two institutions for agriculture to $1.1 billion. The volume of financing would have been higher but for economic, legislative and other difficulties in some member countries. According to recent estimates, the number of agricultural projects ready for consideration by the Executive Directors may rise during 1967-68 to over twenty with a volume of external finance of more than $300 million, political and economic circumstances permitting, and assuming IDA has the needed resources.

Continued support has been provided for large construction projects, such as flood control and irrigation schemes. Agriculture has also continued to benefit from transportation and power projects. The main development recently, however, has been the increased number of projects financed or under investigation which involve farm credit, livestock production, land settlement, seed improvement, grain storage, and training and extension work. Furthermore, on behalf of the World Bank Group, the International Finance Corporation has taken the lead in discussions looking toward the establishment of new fertilizer plants in the developing countries in partnership with domestic firms and companies in North America, Western Europe and Japan. Three such important fertilizer projects reached the financing stage in 1966-67 - in Senegal, Brazil and India - and several others are under discussion.

The Bank Group has greatly strengthened its technical staff over the past few years to enable it to become more deeply involved in financing agricultural development. As Dr. Sen has noted, assistance has continued to be received from FAO under the agreement whereby the two organizations cooperate in the identification and preparation of projects to the point where they can be considered for financing by the Bank or IDA. In Africa, the Bank's two permanent missions on that continent are helping to speed up the flow of agricultural projects ready for financing, while staff of the Agricultural Development Service, based in Nairobi, has been assigned to member countries in Eastern Africa, on a reimbursable basis, to assist in the organization and management of agricultural development projects.

Another critical problem which, like agriculture, merits separate attention, is that of external debt, particularly debtservice, i.e. payments for amortization and interest. I have already mentioned briefly some of the overall figures. The

indebtedness and debt service situations vary widely among countries - a number of countries have relatively small debt service or are in a position to carry relatively large debt service obligations without too much difficulty because of strong export performance. However, for many countries, debt servicing has become a source of serious concern and has reached critical proportions; some countries have found themselves in situations in which a large proportion of their trade and invisible export earnings, say over 20% or even more, is being devoted to debt service. In many of these countries imports simply cannot be compressed appreciably without seriously affecting development. The most recent example of the need to reschedule or refinance debt service payments has been in Indonesia. The debt service problem of the Government of India is now one of the questions being considered by the members of the Consortium for India.

The special problems associated with so-called suppliers' credits - usually of a short and medium-term character and frequently requiring repayment before the full benefits of the investments could be realized - were reviewed in some detail by the World Bank staff in the study prepared at the request of UNCTAD and submitted early in 1967. The study has been made public and is being considered by the appropriate committees of UNCTAD and by other international bodies concerned with export financing and development assistance, such as the O.E.C.D. However, it has now become evident that heavy debt service burdens are being experienced not only by countries which have assumed excessive amounts of short and medium-term external obligations at relatively high interest rates, but also by countries which have followed a fairly cautious debt assumption policy. In these cases export performance has simply not been good enough to cope with rising servicing burdens. Attack on this problem must essentially be along the lines of trying to reduce the burden of servicing, preventing its re-emergence in the future by obtaining external capital on appropriate terms and conditions, and ensuring that countries pursue domestic economic policies designed to improve their export performance, and thus improving their servicing capacities, as well as pursuing policies designed to minimize unproductive public expenditures and maximize savings.

There is room in some countries for the further development of efficient import substitutes, but in many countries such possibilities have been largely exhausted and their persistence with efforts along these lines is interfering with the achievement of stronger and more viable economies.

Concluding Remarks

Thus, the current trends in the world economy, particularly as they affect development finance, are mixed. There are an increasing number of countries which are coping successfully with their development problems; they give basis for hope to all countries that we are not dealing with intractable problems incapable of practical solution. On the other hand, for most of the developing countries, the uncertainties are still causes of grave concern. These uncertainties are both in the ability of the country itself to carry on effective development programs and in the availability of needed external capital on appropriate terms and conditions. Perhaps no single indicator is a better measure of the obstacles facing the less developed countries in pursuing domestic policies designed to achieve more rapid economic growth and rising living standards than the amounts which are being devoted to military expenditures. There are few who would argue that such expenditures are not at the expense of economic development. At the same time it is estimated that almost half of the developing countries are spending amounts significantly above 2% of their gross domestic product for military purposes. As experienced public policy-makers are aware, such percentages represent a substantial portion of the resources which might be available for investment purposes. In some cases 5% and more of domestic gross product is being spent for military purposes.

The process of economic development is a process of changing current trends. The availability of modern technology and "know how" gives us much reason to believe that favorable changes are practical and within the means of the developing countries. However, larger flows of capital on appropriate conditions and more ready access to the markets of the developed countries are also of vital importance. I have listened with interest to the remarks made by previous speakers to the impact of the Kennedy Round. Economic problems do face the developed countries, but the magnitudes of increases in flow of resources from these countries to the developing countries which could be used effectively is in any case economically relatively small for the developed countries. The economic problems which face developed countries are essentially those of how to manage expanding economies which have already reached high levels of output and income. It would seem reasonable to assume that the remarkably expanding world economy which we have witnessed since the end of World War II would be able to provide the additional resources which can be used effectively by the poorer countries to accelerate their development. Moreover, it is important to recognize that our time horizons in the field of development must be much longer for many countries; a decade of development might be long enough for certain countries, but for others it must be thought of in terms of generations.

In our multilateral institutions we try to make our contribution by improving the environment in which both private and public investments from all sources may be made and by helping to enhance the effectiveness of such investments, as well as by directly contributing significant amounts of financing for carefully considered projects to countries pursuing good development policies. In the fiscal year which has just ended, the commitments of the World Bank Group were about $1.3 billion and disbursements were about $1.2 billion. Together with these flows of financial resources, we try to give our members the benefit of whatever practical experience we have accumulated from twenty years of active existence. We try to give assurance to our sources of capital that the funds will be well used and that they will be repaid. Our operations give us intimate contacts with our borrowing members and we cannot but be impressed with their many difficulties. We are also impressed, however, with the successful efforts which are being made by many, and we are convinced that much more substantial progress is practical.

Thank you, Mr. President.

FORM No. 89
(2.66)

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT
ASSOCIATION

INTERNATIONAL FINANCE
CORPORATION

ROUTING SLIP	Date June 27, 1967

OFFICE OF THE PRESIDENT

Name	Room No.
~~Mr. Lars Lind~~	~~453~~
~~Mr. [illegible]~~	
~~Mrs. Fink~~ Pat	

	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

Amelia –
You can put this in the speech book, although in fact, it was not given.
Thanks.

The piece I talked to you about
BL

From Irving S. Friedman

Proposed

Address by

Irving S. Friedman

The Economic Adviser to the President

International Bank for Reconstruction and Development

to

Conference - International University of Social Studies

Pro Deo, Rome

June 22-24, 1967

(Not actually delivered at or to the Conference.)

DRAFT
June 14, 1967

Financing of Development

Today I would like to talk to you about the financing of investment in developing countries, especially the role in it of external capital provided from the richer countries. External capital has been important, and indeed crucial, to many developing countries, but the controversy which surrounds the provision of external capital in the developed countries is beset with many problems of their own, and has at times tended to cloud the efforts which the developing countries themselves are making towards their own development. The major effort in financing investment which is essential to increasing output and improving productivity and thus to promoting development has come -- and indeed must continue to come -- from the developing countries themselves.

External capital has been important in helping the developing countries to grow faster than they would otherwise have done by supplementing domestic savings and by providing part of the means whereby they could pay for foreign goods and services which they urgently need but cannot produce themselves at their lower level of technology and industrialisation. The latter aspect is crucial since the developing countries generally face serious structural difficulties in transforming their domestic resources into foreign exchange under present conditions of world trade. The difficulties which the developing countries face in commodity trade have been the subject of extended discussions between the developed and the developing countries, and have recently been noted by His Holiness the Pope in Encyclical Populorum Progressio, paragraphs 56, 57 and 58. There are a great many things that the underdeveloped countries have to do for themselves in order to obtain more resources domestically, but despite these efforts or rather because of these, foreign capital in development (even though quantitatively a small part of the total investment

resources) will continue to be critically important. However, before giving you some figures which reveal the relative magnitudes of foreign and domestic capital in financing development, let me briefly review the progress which has already taken place in terms of the growth rates achieved.

Between 1960 and 1965, the combined annual growth rate of developing countries as a group has been about 4.8%, slightly higher than the average of the 1950's. In 1966, the gross domestic product in developing countries seems to have increased close to 5% according to preliminary and rough estimates. Among the major regions, the fastest growth rate has been achieved by the developing countries in Southern Europe and the Middle East, at an average of more than 7% per year. The slowest growing regions in the 1960's have been Africa and South Asia, which are also the poorest to begin with, which increased their GDP at average annual rates of 3.6% and 3.2% respectively. In both regions, growth in the first half of the 1960's slackened somewhat from the 1950's.

In per capita terms the growth performance of developing countries was much less satisfactory. The increase in population accelerated to a considerable extent in the first half of the 1960's, leading to some decline on average in the rate of increase of per capita incomes as compared to the 1950's. The combined population growth of developing countries accelerated from 2.1% per year in the 1950's to 2.4% in the first half of the 1960's. Correspondingly, the per capita growth in the 1960's was reduced to 2.4% for all developing countries, and to only 1.7% for developing countries excluding Southern Europe.

This sounds discouraging, and it is discouraging, but these aggregate per capita growth figures do hide the important developments which are taking place in various areas of health, education, and infrastructure in many developing

countries. There are increasing signs that the investments of the past decade and those of the next can make a decisive change from the past stagnation which, in many cases, goes back to the 1920's or earlier. The rate of increase of production in the industrial sector is already averaging over 7% per annum. Agricultural production for the domestic market and particularly foodstuffs, has grown much slower, but agricultural production of export crops has risen markedly in many countries. The rate of savings out of additional income (or the marginal rate of savings) in a few of these countries has been as high as 25% to 30% -- this undoubtedly is an exceptionally high figure, but it is a fair generalization that underdeveloped countries have been trying, and in most cases succeeding, to save more and more of their incomes.

Let me now come to the relative contribution of the domestic savings to investment in the developing or poorer countries.

The data we have for gross national product, savings and investment in the developing countries are necessarily imprecise -- much more so when it comes to totalling them in one global figure to cover all the less-developed countries of the world. However, in the World Bank we have been trying to put some of these data together as best as we can for as many countries as possible, and on the basis of these we have been able to have at least a reasonable idea of the order of magnitudes involved in talking about the less-developed world.

It is our estimate that the gross domestic product (GDP) in the less-developed countries in 1965 amounted to around $255 billion. We also estimate that the average savings ratio to GDP in 1965 was roughly 15%, and the investment ratio around 18%. Applying these rough percentages to the estimate of GDP, we get a figure of about $38 billion for domestic savings in the LDC's and

$46 billion for total investment in these countries, i.e. over 80% of investment was financed in 1965 by the poorer countries themselves. I believe that this percentage for 1965 also reflects the 1967 situation. Thus, notwithstanding the vital role of external capital inflow, it finances the minor part of about 20% of total investments. Share of official foreign aid in financing investment in developing countries has been even less - somewhere around 15%. On a regional basis the share of net capital inflow in financing investments has been higher in Africa, Southern Europe and the Middle East, accounting for about 30%. On the other hand in South Asia and East Asia net capital inflow financed less than 20% of investments, while in Latin America its share is about 12% and probably less.

The ratio indicating the comparative magnitudes of domestic and foreign capital in financing investment in developing countries is an important one for many reasons, especially when consideration is given to proposals for increasing the flow of external development finance to developing countries. One reason is that any increase in the flow of external finance will need to be matched by a much larger savings and investment effort by the poorer countries. When we talk about increasing the flow of external resources to developing countries, it is not meant to be a substitute for domestic efforts, but complementary to these efforts.

The available data and experienced judgment of the Bank staff indicate that an extra $3-$4 billion of official capital will be needed per annum to supplement the feasible domestic effort (in terms of savings and exports) in financing productive investment that could be effectively undertaken in these poorer countries. This judgment is based largely on our firsthand knowledge of the developing countries. The World Bank regularly reviews the economic

position of its individual members. This review includes estimates of the capacity of these countries to generate domestic savings and exports, their ability to pursue satisfactory economic policies, their need for imports and their ability to prepare sound projects and make effective use of capital for such projects. The estimate of official external capital requirements that I have mentioned already assumes a considerable increase in private capital flows to the developing countries. But the flow of private capital is likely to be heavily concentrated in only a few countries, as in the past.

We expect that if an extra \$3-\$4 billion were to be made available to the developing countries, their growth rates in 1970 could average about 6%. On this basis, in 1970 the total GDP of developing countries would stand at somewhere around \$340 billion (at 1965 prices). Applying conservatively the estimated 1970 savings ratio of 17% for the developing countries as a group to this figure, we get an estimate of total savings of around \$58 billion. This is \$20 billion higher than the present level of savings. Thus an increase in development finance of \$3-\$4 billion per annum would be matched by a corresponding increase in savings of \$20 billion per annum by the poorer countries. These are of course very rough figures and should be taken to reflect order of magnitudes rather than precise amounts. What they show is that increase in external capital would be accompanied by a much larger domestic savings effort, rather than substituting for it.

This would be no mean achievement for countries which are starting from a level of income which in human terms is unbelievably low. The savings effort of the magnitude I have indicated would mean that developing countries would be using over 20% of their additional income during this period for investment instead of consumption. I do not have to spell out for this group what this

rate of marginal savings means in terms of sacrifices involved for poor countries. This savings effort out of additional income does not compare too unfavorably with the developed countries, which at their much higher level of per capita income and consumption, have been saving around 25% of their additional income.

Compared to the effort that the developing countries would have to make, I would like to suggest that the burden of providing an extra \$3-\$4 billion in external capital does not seem to be unduly heavy for the advanced countries. This can be seen by comparing this figure with the estimated figures for national income, gross national product at current market prices, total central government taxation, total central government expenditures, or with expenditures for more specific purposes such as gross fixed investment, education and defense, in the developed countries in 1965. The proposed increase in the flow of external finance is roughly three-tenths of one per cent of the national income, 1.5% of central government taxation, little over 1% of the central government expenditure, 1% of the gross fixed investment, 5% of the defense expenditure and 7% of the expenditure on education in the developed countries. In 1970 these percentages might well be even lower, since all the economic indicators for the developed countries I have mentioned would have grown considerably in absolute terms.

Let me emphasize that the estimate of the additional \$3-\$4 billion that I have mentioned is not a prediction of what capital funds will in fact be forthcoming. This is rather an estimate of what external funds would be needed to utilize effectively the capabilities of the developing countries in terms of savings and exports. If external financing is not available in larger amounts, the less-developed countries will, of course, have to accommodate

themselves to what is available, but some of the consequences can be foreseen. A slackening in the rate of investment activity is likely to become unavoidable unless totalitarian methods are used to create more savings by holding down consumption; the growth rate would be reduced; standards of living would rise even more slowly than in the past, particularly in the face of rising population; the pressure to resort to inflationary financing in order to obtain domestic resources would become greater and even more intensive restrictions might be placed on imports and foreign exchange payments. These developments may well discourage the flows of private capital, distort the pattern of investment, discourage private enterprise and initiative in these countries and encourage capital flight from these areas.

On the other side, it cannot be over-emphasized that full use of the suggested increase in flows of external finance, if forthcoming, presupposes adequate performance by the developing countries. The developmental effort of a country must stand up to close scrutiny, both for its own sake and in fairness to other less-developed countries. There can be no compromise with the principle that flow of aid resources -- which do represent a certain cost to the donor countries -- should be used only when the performance of the recipient country warrants it, and there is confidence that these resources would be used with effectiveness for furtherance of development. For, as the Pope says in paragraph 54 of the Encyclical, "Guarantees could be given to those who provide the capital that it will be put to use according to an agreed plan and with reasonable measure of efficiency, since there is no question of encouraging parasites or indolents".

This principle of relating development finance to performance can be implemented in practice. For example, the Bank is engaged, as an integral

part of its day-to-day operations, in making an examination of the current economic performance and a judgment about future performance of its developing members. Even where the financial assistance provided by the Bank has been in the form of loans for specific development projects, it has been interested in the efficiency of total resource mobilization and use in the borrowing countries, for inefficiencies and waste anywhere in the economy reduces or offsets the effectiveness of even the best project, and if serious enough would impair the country's ability to service debt, including debt to the Bank. The Bank's interest in the economic performance of the developing countries in recent years has, moreover, gone far beyond its own operational needs, and has now become an important part of its increasing role in the coordination of aid from other sources to the developing countries, especially in the form of consultative groups. One of the important functions that the Bank assumes in agreeing to organize a consultative group for any country is to make periodic comprehensive reports on the country's possibilities, problems and performance as a basis for the group's deliberations.

From our own experience in the Bank, we are reasonably confident that despite the many disappointments the stage has now been set in many countries for more satisfactory performance in the field of economic policy and for accelerated growth with increasing reliance on the market mechanism. We hope that the developed world will not let this opportunity pass by of making a more effective contribution to such developments in the poorer nations by giving development finance the priority it merits in domestic policy-making in the richer countries.

At present, provision of development finance faces profound difficulties in many countries. In some of the richer countries there is disillusionment with such assistance particularly as to its efficacy; in such climates

governments tend to give greater weight to the costs of foreign aid in terms of budgets or balance of payments than to the benefits. Leaders in such countries frequently recognize the need for development assistance and seek new approaches to accommodate this assistance program to prevailing climates of opinion. Fear of public or legislative repulse still, however, remains strong in some countries. Extremist sentiments in some developing countries which have found expression in anti-foreign acts, including acts against foreign firms have not been helpful in providing inducement for the flow of private capital which is greatly needed. Recent events have made the climate in some countries even more unfavorable, at least for the moment. However, there are also some donor countries such as Canada and Sweden, wherein very different moods and views prevail and political leaders do not have difficulties in advocating the needed development assistance.

The multilateral agencies are in a more favored position because they deal with development finance -- rather than the broad field of aid or assistance -- with objective economic criteria in judging countries and selecting productive projects for loans. Combined with this, to the extent that they adhere to the principles and practice of international competitive bidding for procurement financed by their loans, as is done in the World Bank Group, their loan funds clearly serve the economic objectives of development. However, the unfavorable atmosphere towards foreign aid also seems to make more difficult the ability of some countries to support the multilateral agencies to the extent that many private and governmental leaders wish.

At the moment, the need is for recognition that building of a more stable world economic order for the future takes imagination and vision. Perhaps out of the recent and present crises in the developing areas will come the wider realization that economic and social backwardness threaten peace and prosperity

everywhere. Perhaps closer looks at the quiet progress being made in many countries all over the world, will provide an antidote to the pessimism inevitably generated by the drama of repeated crises.

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(Updated) Transcription of talk at Seminar for Brazilian Professors of Economics, Rio de Janeiro 18-22 Sept 1967

speech-F-

OPENING REMARKS

Irving S. Friedman
The Economic Adviser to the
President of the World Bank Group

I would like to thank you all for attending our seminar. We appreciate very much your willingness to participate. And I also wish to express my appreciation to Professors Gilson and Kerstanetsky for the work that they did to make this seminar possible.

I have been told by my colleagues who attended the Fund seminar about what was covered there. I think that our seminar will, perhaps, be different in character. We intend to concentrate on a few substantive issues which are of interest, I am sure, to you both as professors of economics and as persons engaged in the application of economics to various decision-making matters in both public and private life. These kinds of issues are what we in the Bank Group struggle with ourselves. We therefore thought that it might be interesting to discuss with you our institutional problems rather than to describe our practices and policies in a formal fashion. We understand that you have received the various brochures and materials which explain what the World Bank is, what its mechanics are, what its history is, and the sort of things we do; also, you have our Annual Report.

One thing I do want to emphasize: please do not regard us here as official spokesmen for our institution. We have not come here to explain what the Bank thinks about anything. My colleagues presenting papers here will give you their own personal views. Those of us who are their colleagues are just as interested as you are in finding out what they're going to say. I myself am quite curious about what some of these gentlemen on our staff think about some of these matters. I am sure that I shall find myself in disagreement with some of the things I shall hear; and I am going to take the liberty of indicating when I disagree with them, and I am sure that this right will be exercised by other members of our staff. Unfortunately, all of you are not on our staff, and we do not have the benefit of your views on these questions. But it came to us that, being in Brazil, we had an extraordinary opportunity to benefit by hearing what you think about the kind of problems with which we deal. I am hoping that this will be an academic seminar in the best sense of the word. And so it seems to me that unless universities have changed -- and I hope they haven't -- all of us are students and all of us are professors at the same time. We would like to learn the thoughts of everyone in the room on our questions and to have a full exchange of views.

Now, as the Chairman of this seminar, I hope that I may be forgiven if I make some personal remarks before introducing the various speakers. I feel that perhaps it is appropriate for me to consider myself a link between the Monetary Fund discussions of the last two days and the seminar that we are having today. As some of you know, I spent many years with the Fund before I came to the World Bank. And before the Monetary Fund and the World Bank were established, I was on the U.S. team that was

From "Some Aspects of Economic Philosophy of World Bank" Sept 1968

set up at the beginning of the war to develop proposals on international monetary arrangements -- which led to the Bretton Woods Conference. Afterward I had the good fortune to be put in charge of a U.S. interdepartmental committee to implement the agreement on the World Bank. So from the very beginnings of these institutions -- in fact, even before they were established -- I had the opportunity to be interested in and to know about their organization, their functions, and the economic thinking that went into both. And while I was in the Fund I continued to be interested in the problems of development, although from the point of view of a monetary economist rather than from the point of view of a development economist. In the last three or four years, I have been trying to overcome the ignorance of development economics that I displayed in the Fund and to see if I can fill some of the gaps in my knowledge.

On a less personal basis, I thought it might be interesting -- given the fact that you have had two days of the Fund seminar and also because of my own background -- if I were to compare very briefly the economic work of the two institutions. What do we do? How does the world look with a different perspective? How do both institutions compare? As I say, I do not regard this as an official statement. First, what strikes me as very important is that both institutions are set up with specific purposes and defined objectives, which make clear that if the institutions are to operate properly they must make economic judgments in specific fields of international responsibility and that these economic judgments are to be based on objective economic analysis. It is clear from the origins of both these institutions, as well as the words of their Articles of Agreement, that they were not set up as political institutions. They were set up as technical institutions; and from the very first, great emphasis was given to the need for scientific, economic work as a basis for decision-making. Another major characteristic of both is that they are not research organizations. They were not set up to carry out purely academic work, although a good deal of what might be considered academic work goes on in both institutions. They were set up to make decisions in various financial fields; and to try to get a better understanding of the economic problems of countries as a basis for these decisions. Therefore, the kind of academic work that characterizes academic institutions all over the world will not be found in either the Bank or the Fund; however, I think it is fair to say that the economic work which is done tries to meet academic standards with respect to scientific basis, accuracy, logic, reasoning, data, and so forth. We have close relations with various academic institutions, for we look to them to carry on the kind of work that is not done in policy-making institutions, even when economics plays such an important role in their life and decision-making.

Another interesting thing about the Bank and the Fund, from the economist's point of view, is that we are always working with other professionals, (we are not engaged in what might be considered purely economic questions when we are involved in policy-making). In the Fund, I found myself working a great deal with lawyers. The two professions that are most important in the Fund are economics and law. In the Bank, I find a somewhat broader group: in addition to economists and lawyers, accountants and engineers are important. Before a judgment is reached in the Bank on anything, we receive the benefit of the scientific training of these four professions.

One of our problems in a place like the Bank is for an engineer and an economist to carry on a discussion without confusion and misunderatandings because of differences in professions -- and I am sure that you gentlemen have the same problem of communication among professions. As a relatively new person in the Bank, I find it fascinating to be involved with persons of different professions who are equally interested in accuracy and scientific bases for their judgments, but with different kinds of scientific training, and who are accustomed to using quite different vocabularies in the communication of ideas.

Another aspect that I find interesting in both the Bank and the Fund is that their economic work is subject to the discipline of being made available to a very large audience. The economic work of both institutions ends up by being circulated to all member countries. Some of it ends by being published and thus made available to the rest of the world. We hope that more and more of our work will be the kind that can be published. But whether it is published or not, it is given very wide circulation. The economic work of the Bank results in reports of one kind or another, with hundreds and sometimes thousands of copies being circulated; thus we have the discipline of all the time of finding our work being scrutinized, criticized, attacked, or sometimes praised by people all over the world, and mostly by people deeply concerned with these matters. This kind of discipline is not experienced by persons working privately, and whose audience is much smaller. This is one of the reasons why I personally hope that we shall be able to transform most of our economic reports into publications: I want the discipline of the world on our work. I want people who have scientific training to read it. And I want the people on our staff to know that their reports are going to be read carefully by scientific people; therefore, if there is anything weak in their reasoning or in their analysis or their background research, it will be exposed by such people. I think that with this kind of discipline good work can be achieved. This is why, when I was in the Fund, I took pride in being one of the principal persons in organizing Staff Papers of the Fund. I was interested in the concept of exposing to the world what we were thinking -- not merely to teach but also to receive the criticism of the world. I hope that we shall be doing more of that in the Bank.

I find that, organizationally, the work of the two institutions is very similar. They both have general economic and policy departments and area departments, the difference being that in the Fund there are three or four general departments -- the Research Department, the Exchange and Trade Department, the Fiscal Affairs Department, the Monetary Panel -- whereas in the Bank, all of these functions are within a single department, the Economics Department. But when they are all put together, they add up virtually to the same thing.

Perhaps one other point should be made. Both institutions have the additional discipline that their judgments on situations, on proposals, on investments, on credits, on stand bys are used as bases for activities outside their own institutions. I am sure that you have heard about this in relation to the Fund. What the Bank thinks about a country in terms of an investment program and policies becomes the basis for judgments of our so-called consultative groups, for our consortia, for bilateral creditors

all over the world that are not in consultative groups or consortia, and for private providers of capital. We know that what we say is not going to be used merely for our lending decision; in fact, we may have no loan decision to make on a country. We have to have judgments on countries for which there may not be in sight or even in the foreseeable future a proposal for either an IDA credit or a World Bank loan; but in regard to these countries, other countries or private capital exporters are making decisions, and they look to us for judgments. This kind of responsibility, I think, is very healthy for creating both a good economic staff and for keeping the economic staff on a scientific basis.

Now, what are the differences between the Bank and the Fund? The most obvious difference is the question of priority when it comes to decision-making. In the Bank, our job is to do everything we can to accelerate economic growth and development. We have no other responsibility. And accelerating development, of course, comes down to questions of increasing productive capacity and increasing economic efficiency within the countries that are members of the World Bank. When we come to judge questions like performance -- which will be the subject of Mr. Kamarck's discussion -- our attitude is, and must be, that we judge a country's economic policy by its impact on investment, on savings, on growth -- in short, its impact on the development of the country. We must inform ourselves on the country's monetary policy, fiscal policy, exchange rates, investment programs, planning, foreign trade -- all subjects that will arise in one way or another. We must always ask, what does this mean for the real economy? How will it work its way through the economy? I know that I do not have to explain to you gentlemen the implications of this kind of work and the difficulties. One of the reasons for our having this seminar is to try to get some help on doing our work better.

When I first came to the Bank, I was quite shocked by the length of its economic reports. I was shocked by the length of time and the number of people it took to prepare them. I had come from an institution where a mission was big if there were five people on it. If it took two months to prepare a report, that was considered too long; and if a report was 80 pages in length, people wanted to know why it couldn't be much shorter. Then I came to an institution whose missions have anywhere from 10 to 15 to 20 people, hire outside consultants, take many months to organize and carry out, and then produce not a volume but a library on the country! I must say that at first I was utterly dismayed, and I found myself in a peculiar position when I realized that I would never be able to read all the economic papers being prepared in the Bank. Now, after being with the Bank for three or four years, I find not only that the missions are just as large and just as long, and the volumes just as big and as many, but that we have more of them. So the problem has become worse. The reason is simple, and you as professional economists will understand. In the field of development, work simply is not well done if a detailed investigation of an economy is not made, by sectors and by projects. Also, it is not enough to carry out the investigation in macro-economic terms, which always must be done to start out with; it is essential to examine sectors and projects in great detail. Take, for example, an assignment calling for a complete economic report on Brazil. We realize that it is in some respects an idiotic assignment, for who is capable of sitting down and doing a

thoroughgoing analysis of the entire economy of Brazil? All the gentlemen here, put together, would find deficiency in their knowledge. Such a study would take them all their lives. Therefore, in the Bank we have to make a judgment as to which things are most important, which sectors should be emphasized, which not emphasized. When the report is finished, we find that it is very thorough and very broad. I frankly admit that when I came to the Bank I thought there was something wrong, as the Bank had to spend so much time and effort on one report. Now I have much more understanding of the reasons.

And, I must mention another, different matter: in the Bank, an economist really has to know econometrics and mathematics. If he doesn't, he can't do the work. It's as simple as that. In analyzing a country's investment program, we are in the field of projections, of functional relations; if a person can't handle this kind of analysis, he finds himself really unable to do what, in my opinion, is the most interesting and the most useful part of the work, the part that is uniquely the contribution of the World Bank economist. As Mr. Kamarck will be able to report in detail, we are putting our whole staff through a course of study on the latest econometric techniques, because we know very well that it is essential to get command of these techniques. Therefore, our time has to be spent in acquiring the technical knowledge, to make sure that we in the Bank are doing work that is as scientific as possible.

Perhaps I have said enough now to give you some of my thoughts on what it meant to move from the Fund to the Bank. In the Fund, we did very, very careful work in the field of monetary analysis, and I am very proud to have had a part in that work. We did a great deal of theoretical and practical thinking, and statistical analysis on such things as building a monetary tableau. When I moved to the Bank, I found that another sort of specialization was needed, in order to develop the kind of knowledge necessary for our work.

Our first speaker today will discuss the question of economic performance, one of the critical subjects with which we in the Bank are very much preoccupied. It is of great interest to us in relation to the kind of economic work that we do, the kind of policy decisions that we recommend to our President and to our Executive Directors, and the kind of relationships that we have with countries.

"AN EVALUATION OF TRENDS IN THE WORLD ECONOMY"

By Irving S. Friedman

The Economic Adviser to the President,
International Bank for Reconstruction and Development

(Keynote address prepared for delivery at the 1968 Annual Conference of the Canadian Importers Association in Toronto, April 4, 1968.)

I should like to begin by expressing my pleasure at having this opportunity to visit with you in Canada. I have had a continuing interest in this country, and have often had occasion to become acquainted with Canadian affairs.

Today I have been invited to make some remarks in the way of a keynote address to your important conference. You will understand if I do not try to go into various matters of technical interest to you and to myself in the field of international trade, but rather to deal with some of the broader problems and trends which greatly influence the activities in which you and I are engaged. My assessment is largely derived from personal involvement in current international economic and financial problems, and in our attempts over many years to find solutions to these problems.

The first thought I should like to emphasize is that throughout the years since the end of World War II, the world has enjoyed a period of growth and prosperity without parallel. There has not been a single prolonged depression in any large part of the world. Indeed, for the younger generation, the word depression has virtually been lost from the

vocabulary and substituted by the much softer word recession. Even recessions have been infrequent and relatively short-lived. Another striking feature of this period is the fact that prosperity and growth have not been limited to a few countries, but have characterized countries throughout the world. In statistical terms, it seems that the world has been increasing its production by almost 5% per year. We have now reached the remarkable stage where per capita income in Canada is over $2,000 a year, the per capita income in the United States is about $3,500 per year, and the per capita income in Australia is about $1,700 per year.

Behind these overall figures of growth in the national product, there have been phenomenal changes in various major sectors. Take agriculture in the temperate zones. Wheat production, as you well know, has doubled in the last 20 years. Productivity of agricultural land and labour in the developed countries has increased so that even our great food producers and exporters devote only a small proportion of their labour force to these purposes. In Canada only eight percent of the labour force produces its agricultural output, in the U.S. it is five percent, and in Australia less than 10 percent. This frees most of the labour force in these countries for other economic pursuits. I believe that without these great advances in agricultural productivity, we would not have seen the equally amazing expansion in manufactures and world trade. Perhaps it is because of this experience of temperate zone

agriculture, which defied the many early prophets of gloom, that I am more hopeful than some about the potentialities of tropical agriculture, to which I shall allude a little later.

Some countries, of course, have done better than others. The 20 richest, including Canada, have been growing in their national products at a little less than 5%, on the average. Lower on the scale it may surprise you to know that there are 90 countries that have been growing even faster, as a group. These are the countries with per capita incomes ranging from $150 to $1,200 a year. They include at least a third, and probably more, of the so-called less developed countries, depending on how you define the term. Then at the bottom of the list there are 48 very poor countries and territories. In terms of overall production, even they have been expanding at an average rate of around 3.5% a year, which in earlier periods would have been considered quite good.

The growth of population, however, has prevented much of this increase in production from raising the standard of living at a fast enough pace. In the poorest countries, for example, per capita income has increased by only about 1% a year. This is one of our most frustrating problems. Ironically, part of the difficulty in raising living standards simply reflects the success of modern medical technology in controlling disease and lengthening life. Recently we have begun

to see cause for hope that family planning will become more widely prevalent in the poorer countries.

When we express our regrets that more progress has not been made, it is because we are aware of how far behind many countries are in economic life and how much more needs to be done even in the wealthier communities. It reflects our modern sense of impatience, our hostility to complacency and fatalism, and our confidence that much more can be done if we so will it. We are earth-movers and earth-changers; we simply don't accept the so-called inevitable.

One of the most notable aspects of this period of world-wide growth has been the expansion of trade. Roadblock after roadblock has been removed from the avenues of commerce, so that goods can move more freely today than at any time since before the First World War. The resulting expansion has been unprecedented, adding immensely to the world's wealth. World trade has been growing from two to three times as fast as total production. Canada's own merchandise exports have increased by 270% in 20 years. In the last six years, Canada's trade has grown by more than 90%, while the world total has increased by more than two-thirds.

As with the increase in production, the growth of trade has not been uniform by any means. We could hardly expect it to be. The most serious disparity, however, is between the industrialized parts of the world and the less developed countries, which makes the situation far less healthy than it might be. While the trade of developing countries

has also grown faster than production, their share of the total has fallen markedly in the last six years. Canada's exports alone are more than a fourth as large as the total in the whole developing world, including the petroleum producers -- more than 100 less developed countries with more than two billion people. Canadians, with their own great dependence on foreign trade, can understand the desperate dependence of the poorer countries on their export earnings, which provide about 80% of the foreign exchange now available to them.

As I have suggested, the fantastic growth of trade in the post-war period has resulted in large part from the removal of obstacles that had accumulated for many years. Quantitative restrictions have been greatly reduced, discriminatory practices have been sharply curtailed, and I can testify from personal experience that your Government was always in the forefront of the sustained efforts to achieve this trade liberalization. Tariffs have been steadily and drastically reduced in six major rounds of negotiations since 1947.

In the Kennedy Round completed last year, and now beginning to be implemented, unprecedented reductions were agreed to which will affect about 80% of all world trade, including about $3 billion of Canadian exports and $2.5 billion of imports. A new and basic agreement was arrived at on wheat and other grains. A new Anti-Dumping Code was adopted. Some aspects of the developing countries' special problems were dealt with as well; in fact, 30 of the developing countries took part in the Kennedy

Round negotiations along with all of the major trading nations. The industrialized countries, including both exporters and importers of agricultural products, agreed to contribute to a multilateral food aid program of four and a half million tons a year. And, in principle, at least, it was agreed for the first time that reductions in tariffs on products of particular interest to the developing countries need not require full reciprocity on their part. And this principle has been reaffirmed in the U.N. Trade and Development Conference just completed in New Delhi, India.

I am not underestimating the problems we face today -- capital scarcity; high interest rates; concern about the international monetary system; the difficulties, even in the richer countries, of maintaining full employment and rising incomes without inflation; the frustrations and handicaps of the poorer countries; the painful choices facing governments with huge public expenditures and already heavy tax burdens; the increasing inflexibility of prices and wages, while some primary product prices remain extremely volatile and sensitive; the need to maintain expensive defense establishments; the problems of urbanization; the fantastic obsolescence rate inherent in modern technology; the problems of how to transfer and adapt this technology; the international spread of the consumption habits of North America and Europe; inadequate agricultural output in the developing countries; the already mentioned population problem; and greater expectations everywhere with respect to incomes and employment -- these and other perplexities are deep-seated causes of concern, and will be as long as our mental eye can see into the future.

But there is one overwhelming fact we tend to neglect because of the sustained expansion in the world economy: the economic and social problems we confront today are much more manageable than those that plagued the world before the Second World War. To a large extent, if I may add an aside, the reasons for the failure of some countries to export more must now be sought in their own policies, not in shortcomings of the world economic system.

In addition to much freer trade in terms of tariffs and quantitative and exchange restrictions, we now have a viable system of exchange rates, with internationally agreed par values. I am sure that members of this Association who remember the chaotic conditions before World War II appreciate how important this has been. For decades now, exchange rates have been generally stable. There have been occasional changes and exceptions, but for the most part these have been agreed changes, carried out after careful consideration through established international machinery. All of the major currencies are now convertible. This helps enormously in easing the flow of trade and capital. Of course, there is a price to be paid for this freedom, in the form of unwanted movements of capital or unexpected increases in imports, which may at times make even the skillful managers of balance of payments policies and of foreign exchange markets feel baffled and frustrated. I know that I am prejudiced, having spent most of my adult life helping to achieve this condition of freedom for international trade and finance, but at least the many ills of old-fashioned "beggar-thy-neighbor" policies have so far been avoided. They can be made a thing of the past

if governments are prepared to collaborate in keeping the international economy expanding, while avoiding the perils of inflation. If some people now are fearful that the international financial system cannot be maintained, how different the problem has become! Only a short time ago, the challenge was to create a workable system from a rubble of controls, restirctions and discriminatory practices; today, it is to defend, and, if countries can agree, improve what we already have.

There are many more items that could be included in our inventory of progress. I shall mention just a few. A number of countries have now achieved a state of development which takes them out of the category of the very poor or even poor countries, and brings them much closer to conditions prevailing in the richer countries of Western Europe and North America. Such countries include Jamaica, Mexico, Venezuela and Yugoslavia, to choose a few examples.

The economic growth performance of developing countries has been extremely varied. One or two have been standing still, or even sliding backwar but the rest have been increasing their output. Certainly no other period in history has seen such massive growth on so wide a scale. This is a fact which is far too little known in the industrialized countries, whose aid has provided the support, which though only marginal, has made the achievement possible. There is much more that the developing countries can do for themselves, but even with their best efforts, they need more help. If the truth were better known, I believe that there would be more public support

for international assistance. The opportunities for productive investment, which could hardly fail to return handsome dividends in prosperity and trade as well as in political stability and humanitarian satisfaction, are simply too great to be rejected.

Let me give you just one example, among many. Right now, the chance for a genuine breakthrough in food production which could change the hitherto discouraging prospects of the developing countries located in the tropics, speed their growth and make them far more productive trading partners, seems to be within reach. I refer to the possibilities, already demonstrated, which are offered by the new varieties of rice and wheat that have been developed with the pioneering help of the Rockefeller and Ford Foundations. Together with presently available fertilizer technology, with effective distribution facilities for seed, fertilizer, pesticides and equipment, and with adequate continuing research and advisory services for farmers, it is possible to increase output in many of the most critical areas by a factor of four or five. This has already been proved, especially in Mexico, India, Pakistan and the Philippines.

To take advantage of this opportunity, and otherwise to improve their faltering agricultural performance, the governments of a number of countries have begun to make major, drastic changes in their development policies and have shifted far more weight to this sector. But they badly need help -- skills for research, training and demonstration; foreign exchange to import fertilizers and build plants of their own; help in

establishing the necessary distributive mechanisms and in importing, producing and marketing pesticides and essential farm equipment. The developing countries should act as quickly as possible to do all that is necessary on their part to obtain such aid, while other governments and private industry must be alert to the opportunities for private and public gains that will be mutually advantageous.

To conclude these reminders of post-war accomplishment -- they are hardly even a summary -- I must mention the extraordinary mechanism that has been built up to foster collaboration across the whole spectrum of international economic life. The important thing to remember about this mechanism is that all of it has been built and tested since the Second World War; there has never been anything like it. It has worked well during an era of unprecedented changes and repeated major strains. And it is so far-reaching, so pervasive, so much a part of every aspect of our economic life today, that it is impossible to draw any valid analogies between this and earlier periods. It is simply a fact that we now have the framework for effective international collaboration on both the world-wide and regional levels in nearly every major aspect of international economic life. And this machinery is now experienced and sophisticated. It has come through its painful teething period and is ready and able to cope with our living and therefore difficult world. The names which ought to be mentioned are too many even for a simple listing, but I will say a few words about the GATT because of your special interest in trade, and

about the Fund and Bank because of their intimate importance for trade -- but, probably more importantly, because I have had the opportunity to be closely involved with these institutions from their beginnings, and even during their gestation period.

The General Agreement on Tariffs and Trade, known by its initials as GATT, has organized and provided a forum for all of the post-war trade negotiations which I have mentioned. An interesting fact about GATT, aside from its phenomenal success, is that it was not intended to be an organization at all, which explains its odd name. It started as a temporary arrangement for settling immediate post-war trade problems, pending agreement on setting up a much more ambitious International Trade Organization, usually referred to as the ITO. After a good deal of unhappy controversy, plans for the ITO were quietly abandoned. GATT simply carried on, unobtrusively and without many headlines but with a framework within which the nations could sit down and talk about problems of trade.

The International Monetary Fund and the International Bank for Reconstruction and Development, called the World Bank, were established at the Bretton Woods Conference in 1944 to perform complementary functions in building, after the war, a more stable, prosperous and better-balanced world economy.

Basically, the Fund's task is to help maintain a viable international monetary system, while the Bank helps to build up production, trade and living standards. They are not only "twins" by birth, but also by functions.

The continued success of either one depends on the other -- for the international monetary system is not something which lives apart from the world economy, and the world economy can only grow and prosper within the framework of a viable international monetary system.

Through consultation with member governments, of which there are now 107, and through their commitment to a code of international conduct in monetary affairs, the Fund has played a central role in building the present system of relatively stable exchange rates and currency convertibility. To achieve these vital purposes the Fund has been entrusted with the management of a pool of resources totalling more than $20 billion and its members are now considering whether to entrust it with the responsibility for creating large amounts of new international liquidity in the form of the so-called S.D.R's.

The World Bank has the same membership as the Fund. Voting powers are determined by stock holdings of governments, which in general reflect the economic strength of members. Subscriptions of stock now total nearly $23 billion, but only 10% of that is paid in. The rest, including nearly $14 billion in hard currencies, is a guarantee of the Bank's obligations. With the Bank's sound reputation and such a massive guarantee, representing in hard currencies alone more than four times its outstanding debt, we are able to raise most of the money we lend by selling our bonds at relatively good rates in the United States, Canada and Europe. Our last issue in Canada, incidentally, was sold last February, bringing the total we have raised here to about 98 million Canadian dollars.

The Bank's interest rates to its own borrowers, of course, have to reflect what we pay for money, and its loans have to be made on rather orthodox terms. But development is not an altogether orthodox business. Many countries with low levels of output and savings are faced with a prospect of difficult balance of payments problems for years ahead. Eight years ago, in response to this situation, the Bank's member governments established the International Development Association, called IDA. Virtually all of its funds are in contributions by its 18 wealthiest members -- the so-called Part I countries -- including Canada, and in grants by the Bank out of its net income. IDA funds are kept segregated from those of the Bank, but are administered by the same officers and staff. They are lent on very easy terms: 50 years without interest, but with a small service charge, and with no payment of principal until after a 10-year period of grace.

Thus far IDA has had a total of about $1.8 billion at its disposal. At the present time a replenishment for three years of $400 million a year, with a total of $1.2 billion, is being considered by the various donor countrie.

It should be noted that Canada, Denmark, Finland, the Netherlands and Sweden played a critical role in making this replenishment agreement possible. To fill out the total, they agreed to make supplementary contributions over the same three-year period. In addition Switzerland, which is not a member, agreed to lend IDA $12 million for 50 years without interest. If this $1.2 billion proposal is ratified by governments, it will represent more than a 50% increase on an annual basis. This rise is gratifying and welcom

although it falls considerably short of what is needed, and what could be effectively used.

The Bank also has another affiliate, the International Finance Corporation, which specializes in financing private enterprise in the less developed countries. In essence, it serves as a catalyst between capital, technology and managerial skills in the developed and developing countries. Despite all efforts to encourage it, however, the flow of private capital to developing countries has been generally disappointing.

These three organizations together, which are commonly called the World Bank Group, have so far provided more than $13 billion for about 750 projects in 93 countries on all continents. But this represents only a small part of the total of development finance. In addition to other international institutions, by far the largest amount is provided directly by governments through their own bilateral programs, including that of Canada.

Some of the most interesting elements of this new, closely-interrelated structure are the various mechanisms that have grown up to deal with problems of coordination. The best known, of course, is the Organization for Economic Cooperation and Development, a direct outgrowth of the Marshall Plan. In the Western Hemisphere, the Inter-American Committee on the Alliance for Progress is the most notable example. There are others, such as the Colombo Plan Organization. The World Bank itself has pioneered in the organization of consortia and consultative groups of aid-giving countries, to provide a common

meeting ground for reviewing the economic performance, needs and prospects of individual developing countries in the light of all available knowledge and analysis, and to suggest possible investments.

Despite the great progress of the post-war period, doubt and uncertainty prevail in many quarters. It was evident in the closing sessions of the second United Nations Conference on Trade and Development in New Delhi, from which I returned about ten days ago. The Conference was said, by the newspapers, to have been a failure and in many respects it was. But here were the representatives of more than 100 sovereign nations, rich and poor, all with their particular problems and points of view, dealing with some of the most delicate, complicated and difficult issues the world confronts at a time of extraordinary international financial disturbances. In nearly a quarter of a century of helping to find common ground on which to build, bit by bit, some of the key elements in the machinery I have described, I have learned that no large and complex international issue is ever resolved quickly. It is not surprising that under the circumstances the Conference did not reach agreements resolving major specific issues, and thus many participants left with deep feelings of frustration. The Conference did sharpen international understanding of the issues, and possible hopeful paths of future progress were explored. It is for the future to carry on these efforts, not to be paralyzed into inaction. Conditions will change -- they always do -- and the opportunity to move forward will come, and we will be better prepared to seize it.

So far we have talked economics -- largely production, trade and finance. Time does not permit me to go into other aspects, and indeed my lack of experience may disqualify me from even voicing opinions! But I must add that other changes in thought and practice also impinge sharply upon our economic life and profoundly affect it. Our determination to live in freedom; our concern with the welfare of others -- our rejection of what I call the Law of Diminishing Concern in our attitude towards other peoples; our recognition of the interdependence of countries everywhere on this planet; our new philosophies about the responsibilities of individuals for their actions; our insistence that governments exist to solve problems and that we can fairly judge them by their ability to do so; our new theological approaches, stressing again and in a modern context man's unity and brotherhood; our receptivity to new ideas and confirmation of our belief in the efficacy of competition among ideas -- all these influence everything we do. We who work in commerce and finance are not only the tillers of the soil and hewers of wood; we are part of the extraordinary intellectual ferment of our times, and are helping to make this the Age of Wonder.

I should like to close now with a word about Canada, and its growing role in economic development. I shall simply mention a few items which may tend to get neglected. Many of the less developed countries have an unusual sense of kinship with Canada, despite the great disparity in wealth. I do not know the precise reasons. Perhaps it has something to do with the character of its people, its size, or with its history. Perhaps there is

a feeling that Canadians are also listened to in the counsels of the richer countries, because by their own successes and performance they have earned the respect of all. Whatever the cause, I believe the feeling is genuine, and it is a great asset for Canada and the world. In 1967 Canada's allocation for foreign aid jumped by nearly 45%, having already increased in fi years by 160%. In 1967 there was the inspiring Expo '67: "Man and His World. Canada has come of age, and with maturity has come compassion and understanding for the problems of others, to combine with the earlier virtues of courage and vigor. May I congratulate you all on being citizens of this wonderful country

THE DEVELOPING COUNTRIES IN THE PAST TWENTY YEARS:

GROWTH TRANSFORMATION AND PROBLEMS

by

Irving S. Friedman

The Economic Adviser to the President of the World Bank

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This paper was prepared for the Conference on World Cooperation for Development held at Beirut April 21 to 27, 1968, in response to a request from the co-sponsors, the World Council of Churches and the Pontifical Commission on Justice and Peace, for a background paper on the development experience of developing countries and related aspects. A separate request was also made for a paper on private foreign investment in these countries; for convenience this subject and some other aspects of development finance are also dealt with here.

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I

Introduction

1. This paper deals mainly with the economic indices of development. Development in the poor countries, it hardly needs be said, is, however, a broad-ranging experiment affecting every facet of their national lives -- social, political and cultural - and economic indices cannot indicate by themselves the broader aspects of transformation and change that the developing countries are going through. Even in the economic field, production and income indices do not always measure accurately the extent of progress achieved, since the effort which the poor countries have to make to promote their development is not necessarily reflected in the growth of income or production in relatively short periods of time. It is now more and more widely recognized that the developing countries must first achieve a basic structural transformation of their economies, particularly in order to harness modern science and technology to their production systems. An essential aspect of such a transformation is the building up of social as well as physical infrastructure. The economic justification for these investments is not that they, by themselves, lead in the short run to growth of the national incomes of these countries, but that they will eventually increase the returns to directly productive investments.

2. With these qualifications in mind, we may now turn to the broad facts of the economic development experience of the developing countries. Attached to this paper as Appendix 2 are a series of charts prepared in the World Bank illustrating trends in economic growth, international trade and international finance of these countries.

II

Income and Population

3. First, the national income growth rates. The United Nations declarations on the Development Decade called for an annual rate of economic growth of 5 percent in the developing countries to be reached in the 1960's. The combined average annual growth rates achieved in the developing countries has been somewhat below this target -- actually it was 4.9 percent during the period 1960-66. This compares with a growth rate of 4.7 per annum during the previous decade.

4. Aggregate figures for all developing countries, of course, conceal wide variations. Among the major regions, the fastest growth in the sixties, more than 7 percent per year, has been in Southern Europe and the Middle East. These regions also experienced considerable acceleration in their growth rates in the 1960's compared with the average of the 1950's (in the 1950's, growth rate in both these regions was 5.6 percent). East Asia achieved average growth of 4.9 percent in the period 1960-66, which was somewhat lower than the growth rate achieved in the fifties (5.2 percent). Korea, Malaysia, Taiwan and Thailand achieved growth rates which were much above the average, but the regional average was reduced by sluggish growth in Indonesia.[1] Latin America sustained over-all growth of 4.7 per year in the 1960's. Increases in the gross national product for the region as a whole were held back by the relatively slow expansion of Argentina and Brazil. As a result despite the acceleration of economic growth in Chile, Colombia, Peru and the countries of Central America, the annual average growth rate for the region as a whole was lower in the 1960's than the average of the 1950's.

5. The slowest growing regions in the 1960's, as in the fifties, have been Africa and South Asia. Gross domestic product in these regions increased at average annual rates of 3.3 percent and 3.4 percent, respectively, somewhat less than in the previous decade. The decline in the average for Africa resulted largely from special circumstances in Algeria, where GDP actually declined, and in the Democratic Republic of Congo. The slow growth of India, averaging less than 3 percent per year, chiefly accounted for the sluggishness of the indices of South Asia's expansion in the 1960's.

6. In per capita terms, growth of developing countries has been even slower. Their rate of population growth accelerated to 2.5 percent per year from 1960 to 1966 compared with 2.2 percent in the 1950's. Correspondingly, their average per capita economic growth in the 1960's was reduced to 2.3 percent. All the major developing regions have experienced rates of population growth of over 2 percent in the last decade, except Southern Europe where the growth rate has been 1.4 percent per year. If Southern Europe is excluded, the average per capita income growth in the developing countries in the 1960's is considerably reduced; it amounted to somewhat over 1.5 percent. The fastest growth in population in the sixties, following the pattern observed in the fifties, has been in the Middle East (2.9 percent) and Latin America (2.7 percent). There are also considerable variations among countries -- countries like Argentina, Barbados, Bolivia, Chad, Greece, Tunisia and Yugoslavia had relatively low rates of growth of

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1/ The slowdown in the regional growth rates due to setbacks in the growth of individual countries is only an interesting statistical observation, it does not imply that, as a result of slow growth in one or two countries, other countries in these regions had grown less fast than they otherwise would have.

population (1.6 percent per annum or below), while a considerably larger number of countries e.g. Colombia, Dominican Republic, Ecuador, Guatemala, Honduras, Iraq, Israel, Libya, Nicaragua, Niger, Malaysia, Philippines, Peru, Somalia, Thailand and Venezuela had rates of population growth between 3 to 4 percent per annum. Two countries -- China (Mainland) and India between them accounted for well over one-third of the world's total population. Six countries of the developing regions -- India, Pakistan, Indonesia, Brazil, Mexico and Nigeria -- which together contain 48 percent of the world's population -- had relatively high rates of increase varying from 3.4 percent (Mexico) to 2 percent (Nigeria). Between 1960 and 1966 the population of Asia increased by 200 million - enough to repopulate the entire United States or the Soviet Union.

7. Because of the importance as well as the widespread interest in the subject of population control in the developing countries, it may be appropriate to make some comments on the relationship between population and economic growth. The arithmetic of this relationship is perfectly straightforward -- if production in a society increases by 1 percent, and so does population -- the gain per head in terms of income or production is nil; if population had growth by less than 1 percent, gain in income per head would have been positive. On the basis of this and certain other numerical economic relationships, economists and statisticians have calculated that on average a reduction in population growth rates in the poor countries by 1/10 of 1 percent is equivalent to an increase in capital formation -- or foreign aid -- of $600 million or so.

8. While the arithmetic of this relationship between economic growth and population is perfectly clear; unfortunately, the economics of it is not, and attempts at generalizations in this respect are often misleading. The available data indicate varying correlation between rates of population growth and rates of economic growth in different countries. Countries like Korea, and Thailand, which have experienced high rates of growth have also had rapid increases in their population. In the case of India, on the other hand, a high rate of population growth has served to increase poverty.

9. The point is that what happens to economic growth does not depend on the size and growth of population _per se_ but on whether productive use can be made of rising population. Where there are plentiful natural resources to be brought into use or where productive capacity and efficiency are increasing rapidly and where the population is so sparse that economies of scale remain to be realized, a larger population may be no drawback but actually a positive advantage in terms of the average standard of life. Australia and Canada are important examples of this. Some of the African countries, now sparsely populated, may potentially be able to gain rather than lose from larger population. But for most countries -- India is a leading example -- the existing numbers may already be too large, at least for the foreseeable future, since there already exists a very large potential labor force that requires to be equipped for production. It is in the inability of most developing countries to use their increasing manpower productively that the economic disadvantages of their population

growth lies. Population control for many of these countries seems a necessity -- not only on economic grounds but also on grounds of health, human relations and, indeed, as the very basis of civilized life. In judging the efforts of these countries, however, it is important to remember that it usually takes many years before birthrates can be substantially reduced; also, that the current increase in population in developing countries is largely a reflection of the tremendous progress that has been made in cutting down death rates through better medicines and health care -- in itself a part and a fruit of economic development -- and this increase in population is likely to continue.

Industry and Agriculture

10. Industry has been the most dynamic sector in the developing countries. Over the period 1948-1964 the rate of growth of manufacturing production has been considerably higher in the developing, as compared to the developed, countries. The average annual growth in the developing countries in manufacturing output has been over 7 percent throughout this entire period as against a growth of 5 percent in the developed countries. However, for the years 1965 and 1966, the average rate of growth for both types of economies was 7 percent.

11. On a regional basis the most spectacular increase in the developing world occurred in Asia (excluding Japan). Here an annual rate of growth of 0.8 between 1938 and 1948 was transformed to one of over 9 percent as an average over the period 1950-1964. The Latin American performance was more modest: the region as a whole experienced an average growth rate of just under 6 percent. Aggregative figures are not available for Africa, but the United Nations economic staff has estimated that between the second half of the 1950's and the first half of the 1960's growth in manufacturing industry for the region as a whole (excluding the Union of South Africa) was in the range of 7 to 8 percent per annum.

12. The percentage share of developing countries in world manufacturing production (excluding East European Countries and the Soviet Bloc) increased from 5.1 percent in 1948 to 6.6 percent over the period 1960-64 with Asia accounting for 40 percent of the increase and Africa for 60 percent. Over the same period the Latin American share of world production remained stationary at 3.5 percent. The value of per capita manufacturing production, increased by almost 60 percent for developing countries as compared to increase of just over 40 percent for the developed countries. Another indicator of advance by the developing countries can be seen in the changing composition of gross domestic product by major sectors: whereas manufacturing accounted for 14.5 percent of GDP in developing countries in 1954 this figure has increased to 17.9 percent in the period 1960-1964. The share of manufacturing in the developed countries at these two dates were 30.2 and 31.3 percent respectively.

13. While manufacturing industry in the developing countries increased at a rate considerably higher than in the developed economies, trends in productivity were not so encouraging. It is estimated that output per worker in manufacturing increased at an average rate of about 3 percent per annum during the period 1955-1964 as compared to about 4 percent for the developed countries. Yet it is the increase of productivity which is essential if substantial increases in living standards are to be achieved; it is only by substantial increases in output per worker particularly in agriculture and manufacturing that the rise in population can be offset.

14. In the manufacturing sector development has often been oriented toward substitution for imported manufactures, exports accounting for only a small part of production. The share of developing countries in world exports in manufactures and semi-manufactures, which declined from 6.6 percent to 5.0 percent during the period 1955-58 improved by 1966 when it reached nearly 6 percent. The average annual growth rate in exports of manufactures from these countries has been over 7.5 percent compared with an expansion of 9.5 percent per year in total export volume of manufactured goods. Among the developing countries, the Republic of China, Hong Kong, Israel, Mexico and Yugoslavia have been the most successful in expanding their sales of manufactured goods abroad.

15. The policy of increasing domestic production of manufactured goods to substitute for goods hitherto imported has created serious problems for the developing countries, which some economists had anticipated, but many had ignored in their eagerness to "encourage" industrialization in the poorer countries or their eagerness to "save" foreign exchange because of chronic balance of payments difficulties. In the opinion of the author it remains one of the most important fallacies influencing many governments. For one thing, the foreign exchange saving of import substituting industries has proved to be much less than anticipated because of the continuing need for imports of equipment and intermediate goods. Another important problem has been that almost all developing countries, even those with large population, have small markets, in the economic sense, because of the low levels of income. Consequently, 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 -- production which is uncompetitive in world markets. This has hampered development of exports. It has made balance of payments problems worse and lost the dynamic element of growth which frequently come best from an internationally competitive export sector. It was -- and is -- popular because it seems to serve the purpose of accelerating growth; welcomed by the protected industries, and may be looked upon by foreign aid givers as a means of reducing foreign aid needs. Instead, the author is convinced from observation over many years that it has frequently reduced growth and increased balance of payments needs over time. The problem has been intensified by the restrictive commercial policy of developed countries in lines in which developing countries may have a comparative advantage, e.g., clothing and light manufacturing industries which the developed countries are often eager to protect for their own less competitive industries.

16. It is, however, in agriculture that the growth of the less developed countries has been the most disappointing. The rate of growth of agricultural production in developing countries was, generally lower -- in many instances considerably lower -- than the increase in gross domestic product. This was particularly the case for 1965 and 1966 when drought conditions in many countries worsened an already serious food production situation (Table 3). Per capita food production in developing countries followed an even more dissappointing course with an increase of only 9 percent over the 11 year period 1953 to 1964. The sharp setback of 1965 and 1966 -- per capita food production in the developing countries in the latter year was 4 percent less than in 1964 -- means that much of the progress achieved in earlier years has now been lost. Indeed it is estimated that for all developing regions except the Middle East per capita food production in 1966 was less than before the second World War.

17. Insofar as individual countries are concerned, Table 4 classifies countries in relation to the magnitude of average percentage change in agricultural production over the period 1952-56 to 1963-65. This is compared to average annual changes in food production and population. While there is a general correspondence between high rates of population growth and high food production, there are some countries where these two diverge considerably -- e.g. Iraq and Colombia with rates of population increase of 3 percent and 3.2 percent respectively and average annual growth rates for food production of 1.6 percent and 2.8 percent. At the other extreme are a number of countries -- Burma, Cyprus, Ethiopia, Tunisia -- with annual growth rates in food supply far outpacing population increase.

18. Food production per capita has grown relatively slowly in developing countries over the postwar period. However, the proportion of labor force engaged in agriculture in the developing countries has consistently been falling. For example, in India the proportion of economically active population engaged in agriculture fell from 55 to 49 percent between 1950 and 1963 and in Mauritius from 44 percent to 38 percent between 1952 and 1962. Another encouraging factor is the changing role of agricultural production in gross domestic product over time. For all developing countries agriculture contributed only 30.5 percent of GDP over the period 1960-64 as compared to 35.7 percent over the 1950-54 period. This compares, however, with contributions of 7.2 percent and 8.6 percent respectively for developed countries over identical time periods.

19. The apparent increase in productivity in agriculture is related, to some considerable extent, to the increased use of agricultural inputs such as fertilizers, farm machinery and pesticides. Over the period 1954-1966, total consumption of commercial fertilizers in the developing countries increased by over 300 percent and production increased by just under 300 percent (Table 5). On a regional basis the use of fertilizers increased fastest in Asia: total consumption there increased five-fold during the period 1954-1966. In Latin America, and Middle East, consumption of fertilizers increased threefold; in Africa it doubled.

20. Even so, the tremendous potential for use of more fertilizer to increase agricultural production and productivity can be judged from the fact that while in Western Europe the consumption of fertilizer per hectare of arable land was 130 kg., in North America 52 kg., and in Japan 319 kg., in Latin America it was 16 kg., in the Near East 15 kg., in the Far East 8 kg., and in Africa 2 kg.

21. Mention may be made of the increasing emphasis given by many developing countries to intensified programs for agricultural production through the provision of production prerequisites to farmers. Such programs may include, apart from fertilizers, a whole range of subsidized agricultural inputs -- e.g., improved irrigation facilities, the supply of farm equipment such as tractors, pumps and harvesting machinery, distribution of improved strains of seed or other planting material, the provision of technical advice through extension work. To take a few examples, in West Pakistan the government provides free electrification and drilling facilities for private tube wells. In India beneficiaries of the High Yielding Varieties Program receive various elements of subsidy over a wide range of farm inputs. In North Africa and the Near East grants towards tree planting and small scale afforestation is being increasingly used as an incentive for higher agricultural production and productivity. There is a growing awareness in many countries of what can be achieved through the harnessing of science and technology to agriculture, and governments, as never before, are cognizant of their responsibility as adviser, guide and coordinator.

Savings and Investment

22. Most of the resources for financing development effort in the developing countries come from their own domestic savings. The net contribution of domestic savings to investment varies widely among countries and, though it is not possible to generalize, may broadly be thought of as amounting to roughly 80 percent of the total. A study of a group of 40 developing countries in various regions during the period 1960-65 shows that the contribution of domestic savings to investment was 88 percent in Latin America, 83 percent in East Asia, 81 percent in South Asia, 73 percent in Southern Europe and the Middle East and 68 percent in Africa. Data on savings are often unreliable and become available only after a considerable time lag, but the available evidence suggests that the developing countries are endeavouring to increase the ratio of savings to income. During the period 1960-65, for a group of 40 developing countries, average savings as a ratio of GNP amounted to over 14 percent; in a number of these countries the proportion was considerably higher e.g., Argentina, Brazil, Ivory Coast, Malaysia, Peru, Sudan, Thailand and Trinidad and Tobago. Also, for a large number of developing countries the proportion of savings out of additional income (usually called the marginal savings ratio) is higher than the average savings/income ratio, suggesting that average savings ratio over time is also rising. But for a majority of developing countries, partial data suggest savings rate is considerably lower than 15 percent, and in some cases, as shown in Table 6, has even been declining over time (e.g., Democratic Republic of Congo, Dominican Republic, Ghana, Iraq). Very few industrialized countries, in contrast, save less than 20 percent. On an average, during the period 1960-65, Japan saved as much as 36 percent of

its gross national product; Germany, Netherlands and Switzerland -- all three saved around 28 percent of GNP, Sweden 24 percent, France a little over 22 percent, United States about 19 percent and the U.K. 18 percent.

23. Increasing the rate of domestic savings out of additional income is an especially important task of public policy in the developing countries. It is proving a difficult task in relatively rich countries which already enjoy high incomes. It is a tremendously difficult task in the poorer countries, however obvious the need to do so. The poorer a country, the more difficult it is for it to divert current income away from consumption to investment for a more or less distant future. The levels of consumption are already pathetically low; and the "revolution of rising expectations" which accompanies economic development further puts a premium on current consumption as against investment for the future. There are also many institutional and sociological difficulties in mobilizing savings, arising out of a traditional inclination to hoard rather than save in forms that can be readily mobilized for investments, a large non-monetized sector, fragmentary money and capital markets and underdeveloped banking and savings institutions. These limitations have to be borne in mind in judging the savings efforts of the developing countries.

24. It has been possible for gross investment in most developing countries to be higher than their own domestic savings because of the inflow of private and official financial resources from abroad. For the group of 40 developing countries studied, gross investment has been roughly 17.5 percent of the GNP during the period 1960-65 as compared with somewhat over 14 percent for domestic savings. Recent estimates made in the World Bank show that a number of countries had investment rates as proportion of gross domestic product of more than 20 percent. Among these are Argentina, the Republic of China, Guyana, Korea, Peru, Sudan, Thailand, Trinidad and Tobago, Tunisia and Yugoslavia. In some of these countries a dramatic improvement in the rate of investment has taken place in the sixties, compared with the fifties. For example, Korea's investment as a proportion of GDP increased from 12.5 percent in 1950-59 to 21.6 percent in 1966, and Thailand's from 15.3 percent in 1950-59 to 23.1 percent in 1966. Investment rates such as these compare favorably with a number of developed countries, e.g., the United States which invested 17.6 percent of its gross domestic product during the period 1960-65 or United Kingdom (18.1 percent) or France (21.4 percent).

25. But as with savings, investment rate in a large number of developing countries is considerably lower than the average e.g., Ceylon, Chile, Guatemala, India, Iraq, Nigeria, Pakistan and Philippines. Some developing countries have even experienced declining rates in the sixties compared with the fifties e.g., Algeria, Burma, Congo, Dominican Republic, Iraq, Venezuela. From year to year, the ratio of investment to income has varied according to the level and movement of consumption -- public and private -- as well as the inflow of resources from abroad. The net contribution of resources to developing countries has probably declined in recent years because of a slackening in the inflow of foreign capital, official and private combined, at a time when the outflow of amortization interest, profits etc. from the developing countries has been rising sharply.

External Debt

26. The sharp increase in indebtedness of the developing countries during the last decade is a major aspect of this problem of the probable decline in resource contributions from the developed to the less developed countries. For 92 developing countries, it is estimated that their medium and long-term external public debt increased from $9.6 billion in 1956 to $41.5 billion at the beginning of 1967 -- a more than four-fold increase. The increase in total indebtedness has been accompanied by an increase in the debt service payments by developing countries, which has proved very onerous. The debt service payments by the 92 developing countries increased from under $800 million in 1956 to nearly 3,900 million in 1966. In the more recent period, between 1962 and 1966, debt service payments have grown at an average annual rate of 10 percent, considerably faster than the increase in exports of goods and services by developing countries as a group. (The external public debt and debt service ratios for selected developing countries are shown in Table 7 and Table 8.) The sharpest increase in these payments during this period has been for developing counties of South Asia, East Asia and Africa. The increase was considerably less for Latin America, but the absolute amount of debt service payments by countries in that region have been very large.

27. Although many less developed countries are still able to assume more external debts, the rapid expansion of debt service obligations in recent years has become a matter of grave concern in a growing number of countries. In some cases, the burden of servicing debt has become so acute that it has required arrangements for rescheduling of past debt (e.g., Ghana and Indonesia in 1966; Argentina, Brazil, Chile, Liberia and Turkey in previous years.) The nature of the debt problem facing the developing countries and its close relationship to the terms of aid is exemplified by India. As a proportion of merchandise exports, India's debt service payments (i.e., debt service ratio) increased from 13 percent in 1962 to 22 percent in 1966, resulting from an 82 percent rise in debt service obligations, while exports increased by only 14 percent. India's existing debt and its terms imply an even heavier burden in the future. If there is no change in the terms of present debt 17 and if additional aid is forthcoming in reasonably adequate amounts on terms similar to those of aid given in 1966, the absolute level of annual debt service is likely to double by the early 1970's and triple by the end of the decade. In this case, debt service obligations might increase to 30 percent or 40 percent of export earnings, depending on the rate of export expansion.

28. Unless the terms of aid become more appropriate and commensurate with the debt-servicing capacity of the developing countries, debt crises

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17 Active consideration, however, is now being given to a rescheduling of India's external debts.

are likely to become more general, more frequent and more persistent in the future for countries which are likely to require net inflows of capital for a considerable time in the future. The short-term solution to the problem for the countries already in difficulty may lie in rescheduling or refinancing arrangements for debt service payments due in the next few years, but the longer-term and more basic solution depends on increasing the magnitude and liberalizing the terms of future aid.

29. This follows from the fact that as loan terms harden, the net flow of resources decreases. Thus, for example, assuming a steady level of lending at the rate of $100 per year, simple calculations suggest that the harder the terms, the less the net flow in each successive year. If this loan is extended on "hard" terms (5-1/2 percent interest, 13 years maturity including a 3-year grace period), the annual debt service charges would exceed $100 aid level in the eighth year. Conversely, as loan terms harden and debt service charges mount, more aid is required each year to maintain the same net flow. For example, to produce $100 of net flow in the tenth year, $270 of gross aid is required on hard terms, and only $109 on concessional terms such as those charged by the International Development Association (3/4 percent interest, 50 years maturity including a 10-year grace period.)

30. The recent trends in the terms of official financial assistance to the developing countries do not provide much room for comfort. The share of grants in such assistance is declining rapidly and in 1966 it was about 63 percent as against 76 percent in 1961. Data, compiled by the OECD, on average financial terms of official bilateral loan commitments, show that average terms of loans improved somewhat for loans made in 1964, but in 1965 they became less concessionary. Between 1963 and 1965 interest rates on total bilateral loans increased from 3.3 percent to 3.6 percent, and the average maturity periods decreased from 25.1 years to 22.3 years. However, in 1966 the average interest rates of development loans were once again lower at 3.1 percent (maturity periods were also somewhat longer), but it is not yet clear whether the improvement in 1966 is an indication of a trend or merely a move towards regaining of the average terms of 1964 (see Table 9). There is evidence that in certain cases, at least of India, there is an awareness that improvements in future terms of loans and credits must be made.

31. However, before leaving this brief discussion of the external debt problem, it should be noted that as in other cases, the use of simple ratios like debt service ratios may distort an accurate appreciation of the problem. Aside from the obvious observation that other sources of foreign exchange receipts in addition to exports greatly affect the ability to service debt, there are the more subtle aspects deriving from the fact that the ability to service debt is intimately related to availability of savings both from domestic and external sources and the process by which this savings ultimately affects the balance of payments position of a country. Those public and private policies and activities which increase output, promote national savings, encourage capital inflows

and bring about a more efficient use of savings in productive investments, improve debt servicing capacity. Increasing exports may be used as the formal point of attention, particularly as these increased exports result from increases in efficient output and improvement in the techniques of exploitation of markets in other countries. Countries, are, however, not equally able to increase and diversify exports. For these countries where this results from causes beyond their control or where the process must be very slow, the debt burden may be onerous, even when the debt service ratio is relatively low.

External Capital Flows, Public and Private

32. At the same time, there has been very little improvement in the over-all level of development assistance provided by high income countries during the last six years. The flow of aid from these to the developing countries has remained virtually stagnant at around $6 billion. This contrasts with a near doubling in official aid flows which was achieved in the six years before 1962. (The official capital flows during the period 1956-1961 increased from $3.2 billion to $6.0 billion.) During the period 1950-1955, official capital flows to other developing countries were relatively small, averaging around less than $2 billion. The stagnation of aid flows in the recent years has reflected the stagnation in the assistance to LDC's from the major donor countries, namely, France, Germany, the U.K. and the U.S.A. The share of these countries in the total official aid flow from DAC members declined from 91 percent in 1961 to 84 percent in 1966. The assistance from a number of minor donor countries has, on the other hand, increased markedly during the recent period (e.g., Canada, Japan, Sweden, Austria and Australia), but the effect on the total aid flows has not been marked (see Table 10).

33. The flows of development assistance has been supplemented by flows of private capital. The net flow of private capital is estimated to have averaged around $3.0 billion during the period 1956-1961. For the period 1962-1966, the average flow per year was maintained, but year to year fluctuations were much wider than in the previous period. From the level of $3.0 billion in 1961, they decreased to $2.4 billion in 1963 and then climbed to a peak of nearly $4.1 billion in 1965.17 However, there was a serious drop in the level of these flows in 1966 of about $700 million, mainly accounted by the drop in flows from the United States (see Table 11).

34. Because private investment depends upon a multitude of private decisions, it is also difficult to predict the course of such flows.

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17 In considering the statistics on private capital flows, it must also be remembered that they are subject to a wider margin of error than are official contributions. Whereas the governments themselves keep the record of their own outpayments, in the case of private capital, the record must be inferred from a selected sample of private companies and from the indirect evidence of balance of payments data.

For example, there was a large increase in the flow from the United States in 1964 and 1965; in 1966, there was a large decline. In 1966, the concern over the balance of payments may have had an effect on the general attitude towards further investment abroad, even though the United States continued to regard capital exports to the developing countries as acceptable and desirable. A much more important factor in the decline in the United States private capital flows would seem to be the exceptionally high rates of interest reached in the United States market itself. The high interest rates of 1966 had the effect of attracting the liquid assets of direct investors, and perhaps also led to postponement of planned investment abroad or raising funds outside the United States. This uncertainty in private capital flows resulting frequently from causes outside the host countries creates difficulties in policy making, e.g., in judging the magnitude and composition of development programs, the likely size of the balance of payments deficit, and the financing of anticipated balance of payments deficit.

35. Private investment in the developing countries takes three main forms: direct private foreign investment (in plants, mines, plantations); purchase of stock of existing companies in developing economies; and lending to public or private parties. The private sector of industrial countries also participates in the financing of activities of multilateral agencies by purchasing participations in their loans, and by buying their bonds. Direct investment is the most important of these forms, representing about 60 percent of private capital exports to developing countries.

36. A complete statistical picture of the geographical and functional distribution of private direct investment among developing countries is not available, but partial data for the U.S., France and the U.K. show that a large part of private investment tends to be concentrated in a few countries and within a few sectors in those countries. Thus, for example, manufacturing accounts for about 40 percent of total cumulative U.S. direct foreign investments and petroleum for 30 percent. Of a total U.S. direct foreign investment portfolio in all countries of $54.5 billion at the end of 1966, $11.5 billion (21 percent) was in Latin America and $10.0 billion (18 percent) in all other developing countries taken together. Between 1960 and 1966 the U.S. invested at an average annual rate of only $431 million in countries other than Canada, Western Europe and Latin America. In 1966, however, total U.S. investments in these countries -- which include countries like Australia and South Africa as well as the developing areas -- was the lowest since 1960, falling from a peak of $756 million reached in 1965 to a trough of $375 million. Over the same period the U.S. invested at an annual rate of $1,350 million in Western Europe and $700 million in Canada.

37. In Latin America, the pace of new U.S. direct investments fluctuated widely over the period, but at the end of 1966 was averaging about $210 million a year, with a slow but steady trend of increase from 1962. Seventy percent of investments made during this period in Latin America has been in manufacturing industry; there was actual disinvestment in petroleum. This contrasts sharply with other areas, where 60 percent

of all investments since 1960 has been in the petroleum industry and less than 25 percent in manufactures.

38. The importance of foreign private enterprise in developing countries lies not only in financing the transfer of physical resources, but also -- and even more significantly -- in the transfer of intangible resources such as skills, techniques, and entrepreneurship which accompany direct private investment. Transfers of managerial abilities and technical knowledge may well be of critical importance in accelerating growth and in many cases can be obtained only from their private originators in the more industrialized countries. Industrial technology in the developed countries of the West is primarily the property of private enterprise, being embodied in patents, machines, tools, processes, plant layout, etc. Governments in most cases have great difficulties in marshalling these resources and in transferring them abroad -- unless they have been developed within government-owned operations. There is much to be gained in the developing countries from technological and financial association with the private enterprise in the developed countries, including improvements in ability to market their exports. However, private foreign investment can only take place if the right conditions are created in both the capital-exporting and the capital-importing countries. The developed countries can encourage greater outflows to the developing world by providing incentives to investment in these countries -- for instance by modifying their fiscal systems so as to avoid double taxation and by taking such measures as are required to avoid neutralizing the intended effects of investment inducements granted by host countries. The developing countries on their part can do much to attract foreign capital by adopting positive attitudes towards private investment and, in particular, by providing for its greater security and by pursuing policies that enable companies to operate within a reasonable framework of costs and prices.

39. Certain steps have already been taken by individual countries to provide against political and commercial risks inherent in foreign investment. The government of the United States, for example, guarantees private investments in developing countries against a wide range of political and commercial risks. Under the specific risk guarantee program, losses guaranteed include those due to expropriation or confiscation, war, revolution and insurrection as well as losses on housing mortgages to Latin American countries. As of October 31, 1967, specific risk insurance issued under the foreign aid program amounted to more than $4 billion. Complementing the specific program is the "extended risk guarantee program" under which the U.S. President may determine to reimburse 75 percent of loss against all universal risks except fraud and misrepresentation.

40. The recent implementation of risk guarantee schemes by a considerable number of countries is encouraging;[17] the hope

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17 Latest available information indicates that five countries other than the U.S., i.e., Australia, Denmark and the Federal Republic of Germany, Japan and Norway -- have investment guarantee schemes covering various categories of political risks relating to investments in the less developed countries.

remains that this type of safeguard will be extended to more countries in the future. Risk guarantees constitute a potent weapon in the drive to direct new investments to the less-developed world. In the nineteenth century and right up to the period before the first World War the United Kingdom and to a less extent the more highly-industrialized countries of continental Europe were able to export very large quantities of capital to the then less developed areas of North American and Oceania. Today the situation is quite different. The world's two major capital exporting countries -- the U.S. and the United Kingdom -- are now handicapped by balance of payments difficulties, while other countries have not shown sufficiently sustained interest in foreign private investments to offset the reduced activities of these two countries. Vigorous and imaginative measures are therefore needed to encourage a greater outflow to the less-developed world. The construction of a strong legal and institutional framework for the protection of private investments is an important step in the right direction. In this respect much still remains to be done at the national level.

41. An international initiative in the field of efforts to improve the climate for investment was also taken in October 1966 when "The Convention for the Settlement of Investment Disputes between States and Nationals of other States" came into being under the auspices of the World Bank. The Convention provides for an international machinery which would be available on a voluntary basis for the conciliation and arbitration of investment disputes.

42. One of the most significant developments in the field of public lending in the post-war years has been the phenomenal growth of international lending institutions. From the relatively insignificant levels of multilateral lending in the early fifties, the total commitments by multilateral organizations (chiefly the World Bank, the International Development Association, the European Development Fund, the Inter-American Bank, the European Investment Bank, and various U.N. agencies) amounted to $2 billion in 1966, and disbursements about $1.4 billion. Until mid-1952, the bulk of international assistance was directed towards European recovery; the World Bank, for example, from the beginning of its operations in 1946-47 to mid-1952 had disbursed less than $230 million to the developing countries. Today, the Bank's annual disbursements amount to more than $700 million. The total commitments of the World Bank to all member countries increased from less than $300 million in 1951-52 to over a billion dollars in 1964-65, and then dropped a little to around $875 million in 1966-67. During the course of its 21 years of operations, the Bank has lent over 10 billion dollars, has borrowed widely in world markets to augment its resources, has originated and developed a highly varied program of technical assistance activities, and has added two affiliates to assist the development process: the International Development Association which lends on concessionary terms to the poorer countries among the Bank's membership; and the International Finance Corporation which finances and encourages others to finance, productive

private enterprises, especially in the developing areas of the world. The economically more advanced members of the IDA -- the so-called Part I countries -- this year agreed to recommend to their legislatures the replenishment of the resources of the Association to a level of $400 million per year or about 60 percent above the level of $250 million annually in the previous years.

43. In addition to the growth of multilateral institutions in financial terms, an important development in the field of development finance has been the strengthening of supplier-recipient relations through various aid coordinating mechanisms. The World Bank itself has pioneered in the organization of consortia and consultative groups of aid-giving countries, to provide a common meeting ground for reviewing the economic performance, needs and prospects of individual developing countries. The Bank as the chairman of these groups assumes several responsibilities -- on the one hand, it provides to the donor countries information and objective judgment based on extensive field work on the economies of the countries concerned, and possible investment opportunities, and on the other hand, assists the developing country wherever possible to assess its needs and to take measures required to use assistance most effectively. So far eleven such consortia and consultative groups have been organized for the following countries: Colombia, India, Korea, Malaysia, Morocco, Nigeria, Pakistan, Peru, Sudan, Thailand and Tunisia. Parallel to the effort of the World Bank in coordinating assistance are a number of other initiatives in this field, for example, the consortia for Greece and Turkey organized by the Organization for Economic Cooperation and Development, the Inter-American Committee on the Alliance for Progress, and the Colombo Plan Organization.

Export Earnings

44. While important as a source of supplemental resources and even more as a source of much needed and scarce foreign exchange, financial assistance from abroad still accounts for a relatively small part of the foreign exchange earnings of the developing countries. Some 80 percent of the imports of developing countries are still financed out of earnings from their own exports. Especially during the period after 1959, the increase in the exports of developing countries, according to GATT figures rose by 41 percent during the period 1959-60 and 1965-66, compared with an increase of 23 percent during the period 1953-54 and 1959-60. However, despite their acceleration in the early sixties, exports of developing countries continued to lag behind the expansion in world trade. Their share in world exports, which had declined from 27 percent in 1953-54 to 22 percent in 1959-60, fell further to 19 percent in 1965-66. This fall in developing countries' share has been partly due to their concentration on primary products and partly because even in the field of primary commodities themselves, they have been losing ground as compared with the developed countries. World exports of manufactures have seen an exceptionally fast growth during the last decade, by far exceeding the expansion witnessed by primary commodities. In 1965, primary commodities accounted for over 81 percent of the developing countries' exports. The share of manufacturing exports, even though still relatively low, is rising -- it was 18 percent in 1965 compared with around 11.7 percent in 1950.

45. Slow growth of exports of primary commodities is due to sluggish world demand conditions for food, raw materials of agricultural origin and light manufactures. These primary commodities are the victims of the well-known phenomenon that a smaller proportion of incomes is spent on food as incomes grow, of competition from synthetic substitutes and of protectionist policies of industrialized countries. In addition to slow growth, the export earnings of primary producers, in general, show wider short-term fluctuations than those of the advanced countries leading to considerable instability in the export earnings of developing countries. The instability of developing countries' export earnings is further accentuated by the fact that developing countries' exports are usually concentrated on one or two primary products. For example, a recent World Bank survey of 86 developing countries showed that in 1965, 38 countries relied on a single product and 76 countries relied on one to seven products for more than 50 percent of their export earnings from commodity trade. A bad year for one or two commodities may mean a considerable loss of earnings for developing countries which specialize in them.

46. To make matters worse, in a number of cases the shortfalls in export receipts of developing countries can not be foreseen -- this is a specially important difficulty in the context of a planned program of development since future investment plans have to be based on certain expectations with regard to future export earnings, and a sharp unexpected fall in these earnings can seriously disrupt a country's development efforts. To tackle this problem of unexpected shortfalls, an international initiative

was taken recently. In response to a resolution adopted by the First United Nations Conference on Trade and Development in 1964, the staff of the World Bank in late 1965 proposed a scheme, generally known as the Scheme for Supplementary Finance. The Scheme is aimed at defending development programs from the dangers of disruption arising from unexpected adverse movements by providing supplemental resources under certain conditions. The Scheme proposed is based on a close and continuing relationship between the Agency administering the Scheme and the countries concerned, and an understanding regarding the broad content of development plans and policies, including export projections. As long as the performance of the country was satisfactory, judged by its adherence to agreed policies and programs, the Scheme would make available adequate long-term finance to cover an unexpected shortfall from "reasonable expectations", embodied in an export projection. 1/

47. The importance of rapid growth of exports for development needs hardly be emphasized. Growth of export provides the foreign exchange that is essential for meeting the import needs of a higher rate of investment and growth. 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 not only widens the foreign exchange bottlenecks to investment expansion but also facilitates the attainment of a higher rate of domestic savings. A study of economic indicators for 40 developing countries during 1960-65 appears to show that there was a significant relationship between growth rates and the expansion of external trade in the various regions. Areas which experienced more rapid growth -- Southern Europe, the Middle East and the Far East -- also achieved relatively high rates of export growth while areas like South Asia had slow growth of both GDP and exports. The one exception was Africa which had a relatively rapid growth of exports with a slow rate of growth of GDP. However, this reflected to a certain extent the poor growth performance of Algeria and the Republic of the Congo. A similar broad relationship can be discerned in the growth experience of individual countries. Countries with above-average growth rates tend to have above-average rate of growth of export earnings. In countries like China, Israel, Korea, Mexico, Pakistan, Thailand and Yugoslavia, above-average growth rates were accompanied by vigorous growth of exports.

1/ The Scheme has received wide international support both from the developing countries and a number of developed countries. It was examined by a group of governmental representatives, set up by the Trade and Development Board of the United Nations. The Group reported to the Second United Nations Conference on Trade and Development, which has recommended the continuation of the inter-governmental Group to resolve some outstanding issues and report as early as possible to the Trade and Development Board.

III

Social Transformation

48. Beyond economic growth as can be comprehended within the framework of "key" indicators lies the question of whether, and how, governments over the past twenty years have managed to accelerate the process of social transformation necessary to achieve successful development and higher living standards for their people. This has been done, inter alia, by providing more and better medical and health services, education and housing. A few of these important indices of social development are briefly examined below.

Health

49. Although as noted above, there was some improvement in the world food situation in the 1950's, about half of the world's population remained malnourished, undernourished or both. As contrasted to an increase of 59 percent per capita in the food supplies available for human consumption in developed countries over the last 15 years, food supplies per capita in the developing countries increased only 18 percent; furthermore, for the developing regions the increase consisted mostly of vegetable derivatives as contrasted to the developed regions where the increase was mainly in highly nutritional products of animal content. The calorie and protein content of per capita food supplies per day in developing countries were, respectively, 33 percent and 34 percent less than in developed countries twenty years ago; this position had hardly changed at all by 1965. The incidence of malnutrition for the developing regions is about 25 percent, while in developed areas per capita calorie supply exceeds requirements by about 20 percent. 1/

50. The ratio of deaths due to infection and parasitic diseases to total deaths from all causes has, however, continued to decrease. The record of the first half of the sixties was particularly impressive. Over the fifteen-year period 1950 to 1965 deaths from plague decreased from 23,193 in 1950 to 112 in 1965 and from cholera from 130,481 to 13,990; the incidence of smallpox declined from 335,208 to 13,990.

51. Other indices of the state of health were also encouraging. According to available estimates deaths occurred in the world as a whole at a rate of about 16 per 1,000 population annually between 1960-64; in the developing countries, however, the rate was more than double that of the developed

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1/ A committee of nutritional experts reported on calorie requirements to FAO in 1957. Details of measurement of such requirements can be found in Calorie Requirements. Report of the Second Committee on Caloric Requirements, FAO, 1957.

ones -- an average of 20 per 1,000 as compared to 9 per 1,000. On a regional basis mortality in the developing regions was lowest in Latin America (14 per 1,000) and highest in Africa (about 25 per 1,000 population). Over the period as a whole the trend in mortality has been decreasing -- e.g., in Asia where it dropped from 23 to 20 per thousand over the decade 1953-1964. This was achieved despite a scarcity of doctors. The population per physician ratio averaged about 1:900 for the world as a whole in 1965. In Africa it was about 1:21,000 as compared to levels ranging from 1:2,000 to 1:5,000 in most countries of Latin America and from 1:2,000 to 1:3,000 in the majority of countries of Asia and Oceania.

Education

52. The decade of the fifties was one of remarkable progress in educational advancement at all levels. The fight against illiteracy gained pace in countries such as India, Pakistan and the Sudan. Even though progress in those countries was not sufficient to prevent the total number of illiterates from rising, it sharply dampened the previous trend of illiteracy. In 22 out of 37 African countries in 1950 primary enrolment as a percentage of the 5 to 14 age group was less than 19 percent; only in 4 countries did the enrolment ratio exceed 40 percent. A similar survey taken in 1960 showed that in 10 of the countries the enrolment ratio was over 40 percent; only in 12 was it less than 19 percent. Similar comparisons can be made for all of the developing regions.

53. In the first half of the decade of the sixties the world-wide illiteracy rate continued to drop, falling from 44.3 percent to 39.3 percent. The number of literate persons rose from about 879 million to 1,141 million; and those of adult illiterates from around 700 million to 740 million. Insofar as the developing countries are concerned, the increase in enrolment in secondary and primary education has considerably exceeded the rate of increase of population in that age group -- in the Arab countries, for instance, the rate of increase in primary and secondary school enrolment averaged 9 percent and 12 percent respectively as against a population growth of about 2.5 percent in the relevant age group. Both the Latin American and African countries undertook, at international conferences in Santiago (1962) and Paris (1965) respectively, to allocate annually 4 percent of their gross national product for educational expenditure starting from 1965. Asian countries, however, did not find it possible to commit themselves to that target until 1980.

Housing

54. Standards of housing and sanitation have generally deteriorated in the developing countries. The tremendous growth of urbanization in the post-war period has posed new housing problems for all developing countries. The growth of the shanty town and the slum is not a new phenomenon, but it is one which will remain for a long time yet, given the expected acceleration in the growth of population and urbanization and the general inadequacy of resources to cope with the human and social problems and requirements inherent in such growth. A few examples will illustrate the magnitude of the present problem, particularly since they are taken from countries which have shown concern with development and living standards. In

Mexico City, for instance, about 1/3 of the population of 4,500,000 live in shanty towns and squatter settlements, in Ankara (Turkey) the proportion is one-half; in some of the major cities of India it is considerably more than half. In Morocco in 1960 half the urban dwellings had neither kitchen nor private sanitation facilities. Two-thirds had no running water in the houses or courtyards. In the countryside an investigation covering 2,370 families revealed that only one possessed a wash basin and only 4 a shower bath, a mere 1 percent of all dwellings had running water in the house or courtyards. A comparison of results of the 1948 and 1960 censuses in Ghana shows that the number of persons per dwelling increased from 14.2 to 18.4 in Accra; in the country as a whole 12 percent of the inhabitants lived 20 and more to the same house in 1960. In towns of over 50,000 the proportion was 36 percent. Similar examples from many of the developing countries can be given.

IV

Concluding Statement

55. This paper has ranged over a wide field. What does the analysis of the development experience of the developing countries add up to? There is little doubt that there has been growth; the living standards in the developing countries are better today than twenty years ago. Yet, it is no secret that there is considerable frustration and gloom over the performance and prospects of the developing countries. This is unfortunate; it is true that, given the expectation with which the process of development began in the developing countries, the actual gains in income growth have proved to be inadequate. Similarly, population growth has been fast; in many developing countries investment and savings rates are not good enough; and their exports have not been increasing fast enough. On top of all this, there is also the fact of political instability, internal strife and external clashes. This, however, is not the whole story.

56. Indications of social transformation, referred to in Section III, may be, even from a strictly economic viewpoint, more important as indicators of potential gains (or losses) in the future than key economic indicators; they reflect achieved changes in standards of living. Today more children go to school in developing countries than ever before, more villages are electrified, there are more doctors in relation to population, more people read and write, there are more roads, more schools, more clothing, and so on and so forth. Similarly, the increase in population is also a reflection of the tremendous progress that has been made in cutting down death rates, through better medicine and health care.

57. Much, however, remains to be done. 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 pace of change. It is not sufficient that developing countries expand their physical capacities -- in roads and railways, power plants and irrigation works -- however important these may be. An equally important and perhaps more difficult task is to work out

development strategies and ascertain that they can be implemented within the framework of a sufficiently coordinated and efficiently functioning administrative system, to protect cultural values, to reorganize financial institutions and condition them to requirements of balanced economic growth, to reform tax structures. Over the last twenty years economic planning as an economic discipline with its own methods and procedures has emerged as the harsh harmonizer of national yearnings and aspirations against practical realities. If it has served no other purpose -- and the author does not share this view -- it has at least brought out starkly into the open the gap between emotional hopes and possible fulfillment, between minimal needs and relative availabilities.

58. In the process of experimenting with new techniques and of trying out new ideas we have learned a great deal from the experience of the past twenty years. Our present need is to apply this experience. In the developing countries, this means more carefully drawn up development programs and creating the conditions for their persistent and successful implementation, and for the developed countries this means providing the needed external capital to support these well-conceived programs as long as they are implemented with determination and vigor. The world-wide effort to accelerate growth and avoid the consequences of a failure to cope with this most profound economic problem of our age, may not succeed. If it fails, however, it will not be because we do not know enough, but because we could not create the political will to apply this knowledge wisely.

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TABLE 1

REAL GROSS DOMESTIC PRODUCT, POPULATION AND GROSS DOMESTIC PRODUCT PER CAPITA
(Average Annual Rates of Growth, %)

	1950-60	1960-66	1950-66
DEVELOPING COUNTRIES			
GDP	4.7	4.9	4.7
Population	2.2	2.5	2.3
GDP per capita	2.4	2.3	2.3
Africa /1			
GDP	4.4	3.3	4.0
Population	2.2	2.3	2.3
GDP per capita	2.2	1.0	1.7
South Asia /2			
GDP	3.6	3.4	3.6
Population	1.9	2.5	2.2
GDP per capita	1.7	0.9	1.4
East Asia /3			
GDP	5.1	4.9	5.1
Population	2.5	2.7	2.6
GDP per capita	2.5	2.1	2.4
South Europe /4			
GDP	5.6	7.7	6.4
Population	1.4	1.4	1.4
GDP per capita	4.1	6.2	4.9
Latin America /5			
GDP	4.9	4.7	4.8
Population	2.9	2.9	2.9
GDP per capita	1.9	1.7	1.8
Middle East /6			
GDP	5.6	7.2	6.2
Population	3.1	2.9	3.0
GDP per capita	2.4	4.2	3.1

/1 Algeria, Rep. of Congo, Ethiopia, Ghana, Kenya, Malawi, Morocco, Nigeria, Rhodesia, Sudan, Tanzania, Tunisia, Uganda, U.A.R., Zambia.
/2 Burma, Ceylon, India, Pakistan.
/3 Rep. of China, Malaysia, Philippines, Thailand, Indonesia.
/4 Cyprus, Greece, Portugal, Spain, Turkey, Yugoslavia.
/5 Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Rep., El Salvador, Ecuador, Guatemala, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Trinidad and Tobago, Uruguay, Venezuela.
/6 Iran, Iraq, Israel, Jordan, Syria.

Source: World Bank

Table 2a

REAL GROSS DOMESTIC PRODUCT:
ANNUAL AVERAGE GROWTH RATES IN SELECTED DEVELOPING COUNTRIES

COUNTRY	Total GDP			GDP per Capita		
	1951-59 (%)	1960-65 (%)	1966 (%)	1951-59 (%)	1960-65 (%)	1966 (%)
Algeria	7.7	-3.0	..	5.4	-4.8	..
Argentina	2.5	4.1	-1.2	0.5	2.5	-2.7
Brazil	5.9	4.6	4.5	2.7	1.5	1.6
Ceylon	3.4	3.5	..	0.9	0.9	..
China, Republic of	8.2	9.5	8.1	4.7	6.0	5.1
Ethiopia	..	4.3	3.5	..	2.6	..
Ghana	..	3.8	1.1	..	1.1	-1.5
India	3.3	3.5	..	1.5	1.0	..
Indonesia	4.0	2.7	2.6	1.9	0.4	0.2
Iran	..	5.9	8.0	..	3.0	4.9
Israel	11.5	9.5	0.6	5.6	5.6	-1.9
Korea, Republic of	5.4	5.8	12.8	..	2.9	10.0
Malawi	4.8	4.0	11.2	..	1.6	8.6
Malaysia	2.6	6.8	6.1	-0.3	3.7	3.0
Mexico	6.0	6.0	8.2	2.7	2.5	4.6
Morocco	2.0	2.9	-2.0	-0.7	0.2	-4.1
Nigeria	3.5	5.1	5.4	1.5	3.0	3.4
Pakistan	2.9	5.3	5.1	0.5	2.6	2.4
Panama	4.4	8.1	7.0	1.5	4.7	3.6
Peru	4.7	7.1	6.0	2.3	4.0	2.8
Philippines	6.1	5.1	5.6	2.9	1.7	2.0
Sudan	4.3	7.2	..	1.4	4.3	..
Syria	3.1	7.9	..	..	4.6	..
Tanzania	..	3.1	8.1	..	1.2	6.1
Thailand	6.9	7.5	8.6	3.8	4.4	5.4

Table 2a (cont.)

COUNTRY	Total GDP			GDP per Capita		
	1951-59 (%)	1960-65 (%)	1966 (%)	1951-59 (%)	1960-65 (%)	1966 (%)
Tunisia	..	5.5	0.2	..	4.2	..
Turkey	6.8	2.8	9.1	3.8	0.4	5.8
Uganda	4.3	3.7	6.0	1.8	1.2	3.4
United Arab Republic	6.2	6.3	..	3.7	3.5	..
Venezuela	8.3	4.4	3.0	4.1	0.9	-0.5
Yugoslavia	8.9	7.6	..	7.6	6.3	..
Zambia	6.0	4.0	27.6	3.1	1.1	23.4

Source: World Bank

Table 2b

AGRICULTURAL AND MANUFACTURING PRODUCTION:
ANNUAL AVERAGE GROWTH RATES
IN SELECTED DEVELOPING COUNTRIES

COUNTRY	PRODUCTION			
	Agricultural		Manufacturing	
	1951-59 (%)	1960-65 (%)	1951-59 (%)	1960-65 (%)
Algeria	0.9	-0.5	5.7	-3.5
Argentina	0.9	0.6	0.7	4.5
Brazil	5.5	3.7	9.0	6.7
Ceylon	2.2	3.2	..	6.2
China, Republic of	5.3	4.7	14.4	15.9
Ethiopia	4.0	3.2	6.4	15.0
Ghana	4.9	4.5	..	8.6
India	3.7	1.3	6.4	7.6
Indonesia	2.3	0.6	..	1.4
Iran	5.2	2.4	..	..
Israel	11.3	7.5	7.4	13.3
Korea, Republic of	8.9	7.1	15.1	10.9
Malawi	..	3.8	..	..
Malaysia	3.2	4.5	..	9.0
Mexico	6.9	5.2	7.7	8.1
Morocco	2.8	3.1	4.2	4.9
Nigeria	6.6	3.0	..	6.1
Pakistan	1.8	2.8	21.1	13.5
Panama	4.6	3.9	5.4	14.3
Peru	2.5	3.0	7.7	10.4
Philippines	3.1	3.0	11.0	5.5
Sudan	5.9	3.0	6.4	8.1
Syria	1.9	8.0	6.5	10.1
Tanzania	6.5	2.5	..	11.7
Thailand	3.3	5.6	6.7	9.7
Tunisia	2.3	1.2	..	5.8
Turkey	3.3	1.9	5.9	9.6
Uganda	1.6	2.6	3.5	4.7
United Arab Republic	3.4	3.4	8.9	19.6
Venezuela	4.0	5.8	14.7	8.5
Yugoslavia	12.8	-1.3	11.7	12.1
Zambia	..	3.5	..	12.8

Source: World Bank

Table 3.

INDICES OF WORLD[1] AND REGIONAL AGRICULTURAL PRODUCTION IN RELATION TO POPULATION

	Average 1948-52	1956	1958	1960	1961	1962	1963	1964	1965	1966 (Preliminary)
TOTAL PRODUCTION	Indices, average 1952-56 = 100									
ALL AGRICULTURAL PRODUCTS										
Western Europe	84	103	109	119	118	126	128	129	129	133
North America	93	103	106	109	108	112	119	117	118	117
Oceania	90	106	117	123	125	133	137	142	135	147
Latin America	88	108	119	122	127	130	134	137	141	136
Far East 1/	87	108	112	122	126	128	132	136	133	137
Near East	84	110	119	124	124	136	140	143	145	147
Africa	87	107	111	123	120	127	133	135	137	134
FOOD PRODUCTS ONLY										
Western Europe	84	103	109	119	119	126	128	129	130	134
North America	92	104	109	111	110	113	121	119	121	124
Oceania	93	101	117	123	123	135	138	144	136	153
Latin America	88	110	118	118	123	125	132	138	138	136
Far East 1/	87	108	113	123	127	128	132	137	133	138
Near East	83	110	119	123	124	134	138	139	141	144
Africa	88	107	110	121	118	125	130	132	132	130

1/ Excluding China (Mainland).

Table 3 - Cont.

	Average 1948-52	1956	1958	1960	1961	1962	1963	1964	1965	1966 (Preliminary)
PER CAPITA PRODUCTION										
ALL AGRICULTURAL PRODUCTS										
Western Europe	87	102	106	113	112	118	118	118	117	120
North America	100	100	98	98	96	97	102	98	98	97
Oceania	99	101	107	107	106	111	112	113	106	113
Latin America	98	102	106	103	105	104	104	103	103	97
Far East 1/	93	104	104	107	109	108	109	109	105	106
Near East	93	105	108	108	105	112	112	112	110	109
Africa	95	102	101	106	101	105	107	106	105	101
FOOD PRODUCTS ONLY										
Western Europe	87	102	106	114	112	118	118	118	118	120
North America	99	101	101	100	97	98	104	100	101	102
Oceania	102	97	107	107	105	112	113	116	106	118
Latin America	98	104	105	100	101	100	102	104	101	97
Far East 1/	93	104	104	109	110	108	109	110	105	106
Near East	92	105	108	106	105	110	111	108	107	106
Africa	96	102	100	104	100	103	104	104	101	97

1/ Excluding China (Mainland).

Source: FAO

Table 4.

AVERAGE ANNUAL CHANGE IN AGRICULTURAL PRODUCTION, FOOD PRODUCTION, AND POPULATION IN INDIVIDUAL DEVELOPING COUNTRIES, 1952-56 TO 1963-65

	Agricultural Production	Food Production	Population
	Average annual percentage change[1]		
Agricultural production increased			
4.0 percent or more			
Libya	6.7	6.9	3.5
Guatemala	6.1	3.2	3.1
Korea, Rep. of	5.9	6.2	2.6
Mexico	5.4	5.6	3.4
Venezuela	5.0	5.3	3.6
Thailand	4.5	4.2	3.0
China (Taiwan)	4.4	4.4	3.4
Syria	4.4	2.8	3.1
Brazil	4.3	4.6	3.0
Honduras	4.0	3.4	3.1
3.0 to 3.9 percent			
West Malaysia	3.7	4.7	3.1
Cyprus	3.7	3.8	1.2
Panama	3.7	3.7	2.9
Ethiopia	3.7	3.3	1.7
United Arab Republic	3.6	3.7	2.5
Iran	3.6	3.2	2.4
Turkey	3.5	3.1	2.9
Philippines	3.2	3.1	3.2
Ceylon	3.1	3.4	2.5
Peru	3.0	2.7	2.7
2.0 to 2.9 percent			
Burma	2.9	3.1	1.9
Tunisia	2.9	3.0	1.8
Colombia	2.9	2.8	3.2
Pakistan	2.5	2.8	2.4
India	2.5	2.4	2.2
Morocco	2.3	2.4	2.8
Chile	2.2	2.3	2.4
0 to 1.9 percent			
Iraq	1.7	1.6	3.0
Argentina	1.6	1.6	1.7
Indonesia	1.2	1.3	2.2
Cuba	0.7	0.7	2.1
Agricultural production declined			
Uruguay	- 0.1	- 0.1	1.5
Algeria	- 1.2	- 0.9	1.8

1/ Compound rate: minus sign denotes decrease.
Source: FAO

Table 5.

CONSUMPTION AND PRODUCTION
OF COMMERCIAL FERTILIZERS [1]

	Total consumption			Consumption per ha. arable land	Production		
	1954/55	1964/65	1965/66	1965/66	1954/55	1964/65	1965/66
	----- Million tons ------			Kg.	----- Million tons ------		
Western Europe	7.6	13.1	13.5	130	9.1	15.1	15.9
Eastern Europe and U.S.S.R.	3.3	8.5	10.1	36	3.9	9.5	11.1
North America	6.1	10.6	11.7	52	6.0	12.4	14.4
Oceania	0.7	1.4	1.6	46	0.6	1.2	1.3
Japan	1.2	1.8	1.9	319	0.9	2.0	2.2
Developed Countries [2]	19.0	35.8	39.3	59	20.5	40.6	45.5
Latin America	0.5	1.4	1.5	16	0.4	0.7	0.8
Far East [3, 4]	0.4	1.9	2.1	8	0.1	0.7	0.7
Near East [5]	0.2	0.5	0.6	[6] 15	0.1	0.3	0.3
Africa [7]	0.2	0.3	0.4	2	0.1	0.2	0.2
Developing Countries	1.3	4.1	4.6	7	0.7	1.9	2.0
World Total [4]	20.3	39.9	43.9	33	21.2	42.5	47.5

1 In terms of nutrient content (N, P_2O_5 and K_2O).
2 Including Israel and South Africa.
3 Excluding Japan.
4 Excluding China (Mainland).
5 Excluding Israel.
6 Consumption per hectare of cropped land; because of extensive multi-cropping in the United Arab Republic and fallow in other Near East countries, consumption per ha. of arable land is only 8 kg.
7 Excluding South Africa.

Source: FAO

Table 6.

SAVING AND INVESTMENT IN DEVELOPING COUNTRIES

	Savings 1/ (% of gross national product)		Investment 2/ (% of gross domestic product)	
	1950-59	1960-65	1950-59	1960-65
Algeria	6.7	15.0	20.1	17.8
Cameroon	10.1	9.8	11.2	10.8
Congo (Demo. Rep.)	26.5	9.8	24.2	11.0
Ghana	15.1	12.6	15.9	16.3
Ivory Coast	17.1	16.4	12.4	15.9
Malawi	4.7	3.7	15.1	15.4
Nigeria	8.2	8.0	15.1	15.4
Sudan	17.2	21.3	18.4	21.9
Tunisia	-	9.4	-	21.1
Argentina	17.9	19.6	18.9	20.3
Bolivia	5.4	8.5	14.6	15.2
Brazil	14.8	16.2	15.8	17.6
Chile	9.1	9.9	9.7	12.6
Colombia	17.2	16.1	17.3	19.1
Costa Rica	14.2	10.4	18.4	16.5
Dominican Republic	16.1	12.0	16.3	12.1
Ecuador	17.6	12.2	13.9	14.4
Guatemala	9.9	8.4	11.3	11.6
Guyana	15.0	16.6	20.8	20.5
Honduras	13.4	12.7	14.5	14.0
Jamaica	9.5	16.2	18.2	19.8
Mexico	15.7	16.1	17.4	17.8
Paraguay	12.8	11.8	15.0	16.0
Peru	19.4	20.5	23.2	21.0
Trinidad & Tobago	20.3	20.8	24.4	26.8
Uruguay	11.6	13.0	13.6	15.1
Venezuela	28.0	24.8	27.0	19.0
Burma	19.1	17.0	18.2	17.9
Ceylon	13.3	11.8	12.3	13.8
China (Taiwan)	10.7	15.4	16.9	19.6
India	n.a.	11.3	n.a.	13.6
Korea	4.4	4.3	12.5	13.8
Malaysia	20.5	21.0	11.1	17.3
Pakistan	n.a.	9.0	n.a.	12.8
Philippines	7.3	12.4	8.6	13.2
Thailan	13.4	18.4	15.3	19.8

Table 6 - Cont.

	Savings 1/ (% of gross national product)		Investment 2/ (% of gross domestic price)	
	1950-59	1960-65	1950-59	1960-65
Iran	15.5	15.5	16.3	15.2
Iraq	23.6	17.2	18.8	13.9
Israel	9.4	13.8	29.7	29.2
Spain	17.2	21.3	18.4	21.9
Turkey	10.7	11.2	12.7	14.1
U.A.R.	n.a.	12.0	n.a.	16.4
Yugoslavia	n.a.	n.a.	34.0	38.4

1/ Gross national savings

2/ Gross domestic investment

Source:- World Bank

EXTERNAL PUBLIC DEBT OUTSTANDING JANUARY 1, 1967 OF COUNTRIES CONSTITUTING ABOUT 75% OF THE DEBT OF ALL DEVELOPING COUNTRIES

(In 000 $)

Country	Debt outstanding January 1, 1967	Cumulative percentage
India	7,318,057	17.6
Brazil	3,201,244	25.4
Pakistan	2,533,278	31.5
Mexico	2,235,914	36.9
Argentina	1,887,792	41.4
Yugoslavia	1,715,463	45.6
Indonesia	1,697,934	49.6
Turkey	1,552,200	53.4
Chile	1,259,977	56.4
Iran	1,021,606	58.9
Colombia	1,013,149	61.3
Israel	933,027	63.6
Peru	891,866	65.7
Nigeria	593,619	67.2
Afghanistan	552,691	68.5
Korea	551,601	69.8
Greece	459,943	70.9
Venezuela	453,950	72.0
Ghana	443,415	73.1
Philippines	428,632	74.1
Algeria	422,166	75.2
Total	31,172,524	75.2
All developing countries	41,472,934	

Source: World Bank

RATIO OF SERVICE PAYMENTS TO EXPORTS FOR 1966 AND EXTERNAL PUBLIC DEBT OUTSTANDING JANUARY 1, 1966 AND 1967 FOR 20 COUNTRIES WITH LARGEST RATIOS

(amounts in 000$)

Country	Service payments / Exports %	Debt outstanding including undisbursed	
		January 1, 1966	January 1, 1967
Mali	71.0	135.9	193.1
Brazil	29.4	3,054.0	3,201.2
Indonesia	25.5	1,919.5	1,697.9
Israel	24.9	118.0	933.0
Argentina	23.9	1,960.5	1,887.8
Yugoslavia	21.8	1,855.5	1,715.5
Mexico	21.1	2,053.9	2,235.9
Ghana	20.4	494.6	443.4
Uruguay	17.5	275.3	258.5
India	16.3	6,256.3	7,318.1
Chad	15.0	20.6	23.5
Dominican Republic	14.3	126.0	172.0
Colombia	13.4	1,039.4	1,013.1
Pakistan	12.0	2,343.2	2,533.3
Tunisia	11.9	364.8	413.6
Turkey	11.6	1,249.9	1,552.2
Chile	11.2	1,228.0	1,260.0
Afghanistan	11.0	555.4	552.7
Costa Rica	10.2	145.4	142.1
Peru	10.0	666.8	891.9

Source: World Bank

Table 9.

AVERAGE FINANCIAL TERMS OF OFFICIAL BILATERAL

LOAN COMMITMENTS, 1962 - 1966

	Weighted Average Maturity Periods					Weighted Average Interest Rates (%)				
	1962	1963	1964	1965	1966	1962	1963	1964	1965	1966
Australia	-	-	-	-		-	-	-	-	
Austria	5.0	19.0	8.8	7.7	6.5	(6.0)	3.0	5.2	5.5	5.2
Belgium	-	-	20.0	16.2	14.6	-	-	3.0	3.0	2.8
Canada	11.6	12.5	25.1	32.9	34.6	6.0	6.0	4.7	3.4	2.4
Denmark	-	-	19.1	13.7	18.7	-	-	4.0	5.3	0.0
France	(17.0) 1/	(15.0) 1/	15.6 1/	17.6	15.3	4.0 1/	4.2 1/	3.2 1/	3.8	3.6
Germany	15.2	18.5	18.1	16.9	21.2	4.4	4.3	4.0	4.2	3.3
Italy	5.8	8.7	9.3	6.3	8.0	6.1	6.1	4.3	4.3	3.7
Japan	10.0	15.0	16.0	12.0	14.4	6.0	5.8	5.8	4.4	5.2
Netherlands	26.5	23.8	24.2	23.9	..	4.0	4.8	3.9	3.5	..
Norway	-	-	17.0	16.0	-	-	-	4.5	3.0	-
Portugal	18.9 1/	20.2	16.3	21.5 1/	..	4.0 1/	3.3	4.1	3.8 1/	..
Sweden	-	20.0	20.0	20.0	20.0	-	2.0	2.0	2.0	2.0
United Kingdom	24.3	21.0	24.0	22.2	23.9	5.8	4.8	4.1	3.3	1.0
United States	28.6	32.5	33.4	27.9	29.3	2.5	2.0	2.5	3.3	3.0
Total D.A.C. Countries	24.5	25.1	28.4	22.3	23.5 2/	3.5	3.3	3.1	3.6	3.1 2/

1/ Gross disbursement data.

2/ Totals include 1965 figures for Netherlands and Portugal.

Source: The Development Assistance Committee, O.E.C.D.

Table 10.

THE FLOW OF OFFICIAL FINANCIAL RESOURCES TO LESS-DEVELOPED

COUNTRIES AND MULTILATERAL AGENCIES, 1956 - 1966

Million U.S. Dollars

	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966
Australia	34	42	48	50	58.9	70.9	73.8	96.9	(104.0)	121.6	128.8
Austria	-	-1	2	7	-0.1	2.2	13.8	2.1	14.6	33.8	36.9
Belgium	20	20	23	79	101.0	92.1	79.8	89.9	81.7	112.4	92.1
Canada	30	48	91	60	75.2	61.5	54.4	98.0	127.7	124.3	208.5
Denmark	3	2	5	13	5.5	8.1	7.4	9.7	10.6	12.9	26.1
France	647	819	884	835	848.3	943.3	977.0	850.7	831.2	752.2	721.1
Germany	142	275	268	332	351.0	618.4	467.8	437.2	423.2	471.6	490.0
Italy	43	164	73	84	110.4	85.3	110.1	110.2	54.1	92.7	117.8
Japan	96	92	285	150	97.7	108.5	88.2	140.3	115.7	243.7	285.4
Netherlands	48	23	40	49	45.7	69.3	90.8	37.8	48.4	59.6	..
Norway	8	9	-	5	10.1	9.0	6.9	20.6	17.1	11.8	13.4
Portugal	3	2	1	17	36.9	43.8	40.8	51.1	61.9	21.2	..
Sweden	3	12	4	18	6.7	8.4	18.5	22.9	32.8	38.1	55.5
United Kingdom	205	234	276	377	407.0	456.8	421.0	414.5	493.4	480.6	501.4
United States	2,006	2,091	2,410	2,322	2,776.0	3,447.0	3,536.0	3,699.0	3,445.0	3,626.8	3,634.0
Total D.A.C. Countries	3,288	3,832	4,411	4,398	4,931.3	6,024.6	5,981.3	6,080.5	5,859.9	6,203.2	(6,391.8) 1/

1/ The total includes D.A.C. estimates for Netherlands and Portugal.

Source:- The Development Assistance Committee, O.E.C.D.

Table 11.

THE NET FLOW OF PRIVATE CAPITAL TO LESS-DEVELOPED COUNTRIES AND MULTILATERAL AGENCIES, 1956 - 1966

Million U.S. Dollars

	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966
Australia	..	(2.9) 1/	(4.0) 1/	..	..	..	..	(6.7)	(20.0)	22.9	7.7
Austria	4.4	-3.8	4.6	-8.3	5.8	18.0	17.2	3.8	6.7	13.5	12.8
Belgium	69.7	16.5	88.9	88.8	81.2	82.4	48.4	95.0	93.0	119.5	90.5
Canada	75.6	83.6	64.1	22.3	69.5	39.4	55.2	32.5	14.1	45.0	55.0
Denmark	1.6	(0.1)	(0.2)	(8.2)	32.4	25.2	7.3	(0.8)	21.2	2.3	(-2.0)
France	477.1	409.7	453.4	336.7	476.8	489.0	420.2	413.9	550.3	567.7	568.7
Germany	275.0	247.5	242.5	474.3	273.7	219.3	182.2	167.3	284.1	255.2	248.2
Italy	90.7	44.6	81.8	65.2	192.9	177.1	284.3	215.9	187.7	177.8	509.7
Japan	26.0	25.0	32.5	43.0	136.7	273.9	199.4	127.0	174.1	241.8	253.5
Netherlands	232.0	122.1	160.5	168.7	203.3	144.4	49.2	96.6	69.2	169.2	..
Norway	0.6	0.2	3.1	1.9	0.1	17.9	-0.1	1.0	5.9	26.6	4.0
Portugal	..	..	..	..	..	..	..	..	..	9.3	..
Sweden	11.8	13.2	22.7	27.0	39.9	43.5	18.8	30.5	34.4	34.6	51.1
United Kingdom	383.7	726.5	392.2	466.6	451.8	446.9	330.1	310.6	422.5	517.1	(472.0)
United States	1,230.3	2,008.7	1,275.0	954.1	1,042.2	1,099.2	819.0	880.0	1,325.0	1,872.8	(979.0)
Total D.A.C. Countries	2,878.5	3,696.8	2,825.5	2.648.5	3,006.3	3,076.1	2,431.2	2,381.2	3,208.2	4,075.3	(3,428.7) 2/

1/ Multilateral portfolio only.

2/ Total includes D.A.C. estimate for the Netherlands and Portugal.

Source:- The Development Assistance Committee, O.E.C.D.

Table 12.

TOTAL OFFICIAL AND PRIVATE FLOW TO LESS-DEVELOPED COUNTRIES AND MULTILATERAL AGENCIES, 1956 - 1966

Million U.S. Dollars

	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966
Australia	..	(44.9)	(52.0)	..	..	..	..	103.6	(124.0)	144.5	136.5
Austria	4.4	-4.8	6.6	-1.3	5.7	20.2	31.0	5.9	21.3	47.3	49.7
Belgium	89.7	36.5	111.9	167.8	182.2	174.5	128.2	184.9	174.7	231.9	182.6
Canada	105.6	131.6	155.1	82.3	144.7	100.9	109.6	130.5	141.8	169.3	263.5
Denmark	4.6	2.1	5.2	(21.2)	37.9	33.3	14.7	(10.5)	31.8	15.2	24.2
France	1,124.1	1,228.7	1,337.4	1,171.7	1,325.1	1,432.3	1,397.2	1,264.6	1,381.5	1,319.9	1,289.8
Germany	417.0	522.5	510.5	806.3	624.6	837.9	650.0	604.5	707.3	726.8	738.2
Italy	133.7	208.6	154.8	149.2	303.3	262.4	394.4	326.1	241.8	270.5	627.5
Japan	122.0	117.0	317.5	193.0	234.4	382.4	287.6	267.3	289.8	485.5	538.8
Netherlands	280.0	145.1	200.5	217.7	250.0	213.7	140.0	134.4	117.6	228.8	..
Norway	8.6	9.2	3.1	6.9	10.2	26.9	6.8	21.6	23.0	38.4	17.4
Portugal	..	..	..	..	..	..	..	..	..	30.5	..
Sweden	14.8	25.2	26.7	45.0	46.6	51.9	37.3	53.4	67.2	72.7	106.6
United Kingdom	588.7	960.5	668.2	843.6	858.8	903.6	751.1	725.1	915.9	997.7	973.4
United States	3,236.3	4,099.7	3,685.0	3,276.1	3,818.0	4,546.0	4,355.0	4,579.0	4,770.0	5,499.6	4,613.0
Total D.A.C. Countries	6,166.5	7,528.8	7,235.5	7,046.5	7,937.3	9,100.7	8,417.5	8,462.1	9,068.1	10,278.6	1/ (9,864.2)

1/ Total includes D.A.C. estimate for the Netherlands and Portugal.

Source:- The Development Assistance Committee, O.E.C.D.

APPENDIX 2: CHARTS

These charts prepared by the Economics Department have not previously been released for use outside the World Bank Group of Institutions.

CHARTS ON TRENDS IN ECONOMIC GROWTH, INTERNATIONAL DEVELOPMENT FINANCE, AND INTERNATIONAL TRADE OF DEVELOPING COUNTRIES

CHART 1 GROSS NATIONAL PRODUCT PER CAPITA OF DEVELOPING COUNTRIES, BY REGION, 1960 AND 1966

During the six years 1960-1966, average annual per capita income in developing countries as a whole rose, in real terms, by less than $25, i.e., by some $4 per year. The average level for all developing countries is about $170 per annum, but for the large majority of the population in developing countries, e.g., in Asia, per capita annual income is about $100. The largest increase in per capita income has been occurring in the highest income countries.

CHART 2 GROSS NATIONAL PRODUCT PER CAPITA OF SELECTED DEVELOPING COUNTRIES, 1950-1966

The generally close correspondence between level and growth rate of income is nevertheless accompanied by considerable individual variations, e.g., the different experiences of India and Pakistan since 1960.

CHART 3 GROSS NATIONAL PRODUCT PER CAPITA OF DEVELOPED AND DEVELOPING COUNTRIES, 1960 AND 1966

During 1960-1966, the <u>increase</u> in the annual per capita income of the principal developed countries exceeded the <u>total</u> average annual per capita income of developing countries as a whole. In the case of the U.S., the increase was several times greater.

CHART 4 GROWTH IN WORLD POPULATION

Latin America has the highest rate of population growth. Though the rate is somewhat lower in South Asia, that region is under the greatest population pressure because of the rate of growth combined with the large size of population. The industrial countries have a minority of the world's population and the lowest growth rates.

CHART 5 CALORIE INTAKE OF DEVELOPED AND DEVELOPING COUNTRIES

Much of the world's population is hungry. Intake of 2,500 calories a day is considered adequate. Developing countries, with the major part of the world's population, average 2,150 calories a day. Developed countries average 3,000 calories a day.

CHART 6 NET FLOW OF FINANCIAL RESOURCES TO LESS-DEVELOPED COUNTRIES

Though the total flow has expanded gradually, the principal component, DAC bilateral official assistance, has been levelling off.

CHART 7 NET FLOW OF FINANCIAL RESOURCES FROM MULTILATERAL AGENCIES TO LDC's

The IBRD Group accounts for about two-thirds of the flow from all multilateral agencies.

CHART 8 NET FLOW OF FINANCIAL RESOURCES FROM DAC COUNTRIES COMBINED AS A PERCENTAGE OF NATIONAL INCOME

The net flow is absorbing a decreasing share of the growing output of the developed countries.

CHART 9 NET FLOW OF OFFICIAL FINANCIAL RESOURCES TO LDC's AND MULTILATERAL AGENCIES FROM SELECTED DAC COUNTRIES AS A PERCENTAGE OF NATIONAL INCOME

The flow of official resources, subject to direct governmental control, has been declining in relation to national income of most of the principal donors, but has been increasing for the smaller donors.

CHART 10 EXTERNAL PUBLIC DEBT OF LDC's (Debts of LDC governments, or guaranteed by them, of maturity exceeding 1 year, including undisbursed, as of January 1 of each year)

Outstanding indebtedness of the LDC's has been increasing sharply, particularly in Asia.

CHART 11 RATIO OF DEBT SERVICE TO MERCHANDISE EXPORTS OF LDC's AS A WHOLE

The rate of increase of debt service for LDC's as a whole has been somewhat faster than that of earnings from exports. Thus the ratio of debt service to exports has risen to about 9 percent.

CHART 12 DEBT SERVICE RATIOS OF SELECTED LDC's

Countries with debt service ratios above the average and relatively low rates of internal growth (i.e., less than 5 percent per annum) have run into difficulties in making payments. In some of these cases creditors have agreed to refinance or reschedule payments due on interest and/or principal.

CHART 13 VALUE OF PRIMARY COMMODITIES AND MANUFACTURES AS A PERCENTAGE OF TOTAL EXPORTS (Data exclude Sino-Soviet Bloc)

In contrast to developed countries, LDC's are heavily dependent on the exports of primary commodities although the share of manufactures in LDC trade is rising gradually. The share of primary commodities in developed countries' trade is shrinking although these products retain a significant minority position, particularly in North American exports.

CHART 14 TRENDS IN WORLD (EX. BLOC) EXPORTS OF MANUFACTURES AND PRIMARY PRODUCTS

Sluggish growth in exports of primary commodities as opposed to rapid growth in exports of manufactures.

CHART 15 QUANTUM AND VALUE EXPORT INDICES

Quantum of total exports of developed countries has been rising faster than the quantum of total exports of the LDC's; the difference is even more marked in the value of exports because the prices of developed countries' exports have gradually risen in relation to the prices of LDC exports.

CHART 16 TERMS OF TRADE

In contrast to developed countries, LDC's have experienced adverse terms of trade compared to 1950.

CHART 17 SHARE OF DEVELOPED COUNTRIES AND LDC's IN WORLD EXPORTS

Share of the developed countries in world trade has been expanding whereas that of the LDC's has been declining.

CHART 18 DIRECTION OF EXPORTS OF LDC's AND OF DEVELOPED COUNTRIES, BY VALUE

Trade among developed countries is increasing faster than their trade with the LDC's or trade among the LDC's.

CHART 19 VALUE OF SIX MOST IMPORTANT COMMODITIES (IN 1960-1965) EXPORTED BY THE LDC's

The six most important commodities (based on 1960-1965 exports) in the export trade of the LDC's are: petroleum, coffee, rubber, sugar, cotton, and copper.

CHART 20 COFFEE PRICE MOVEMENTS

Coffee, the second most important commodity (after petroleum) exported by the LDC's, experienced a sharp price decline after the post-war peak of 1954. Various producers' agreements in 1957-59 had only limited success in decelerating price declines. The International Coffee Agreement of 1962 has succeeded in sustaining prices through its export quota mechanism.

CHART 21 WORLD SUPPLY AND DEMAND FOR COFFEE

Since 1955/56, world exportable production has exceeded export demand and surpluses have been piling up. World producer stocks, mostly held in Brazil, now average over one and one-half years' of world export demand.

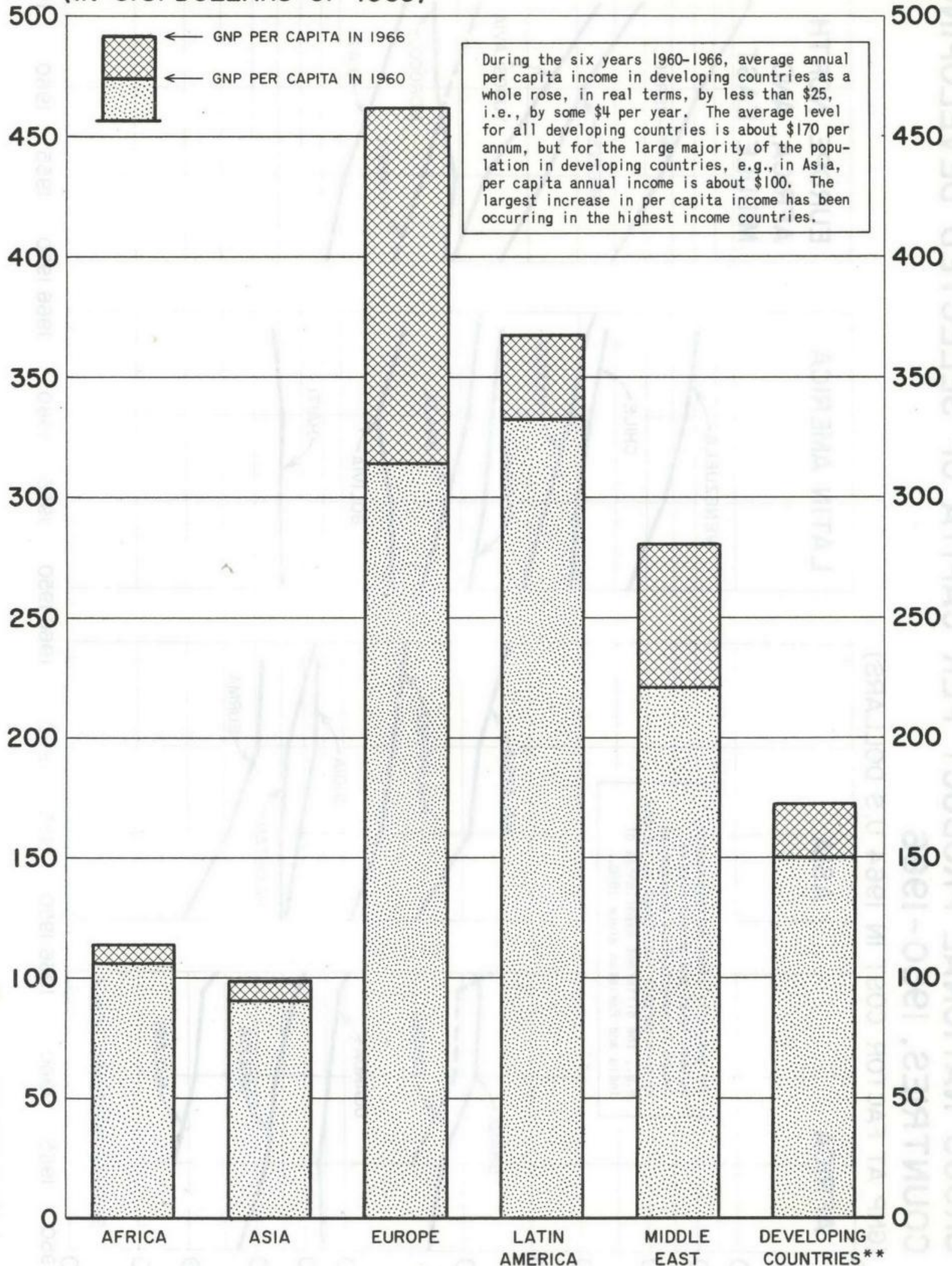
CHART 22 MOST DYNAMIC COMMODITIES (IN 1960-1965) EXPORTED BY THE LDC's

LDC commodity exports which have experienced the most dynamic growth in post-war years are: petroleum, timber, iron ore, bauxite, maize, and fishmeal.

CHART 23 WEIGHTED INDEX OF SELECTED COMMODITY PRICES

In 1960-1967 prices of metals and food products exported by the LDC's have been relatively strong while prices of the agricultural raw materials exported by the LDC's have been declining.

Prepared by Economics Department
April 1968



NOTE: EUROPE includes Cyprus, Greece, Portugal, Spain, Turkey and Yugoslavia.

* Estimated GNP at factor cost.

** Data for developing countries cover 58 countries.

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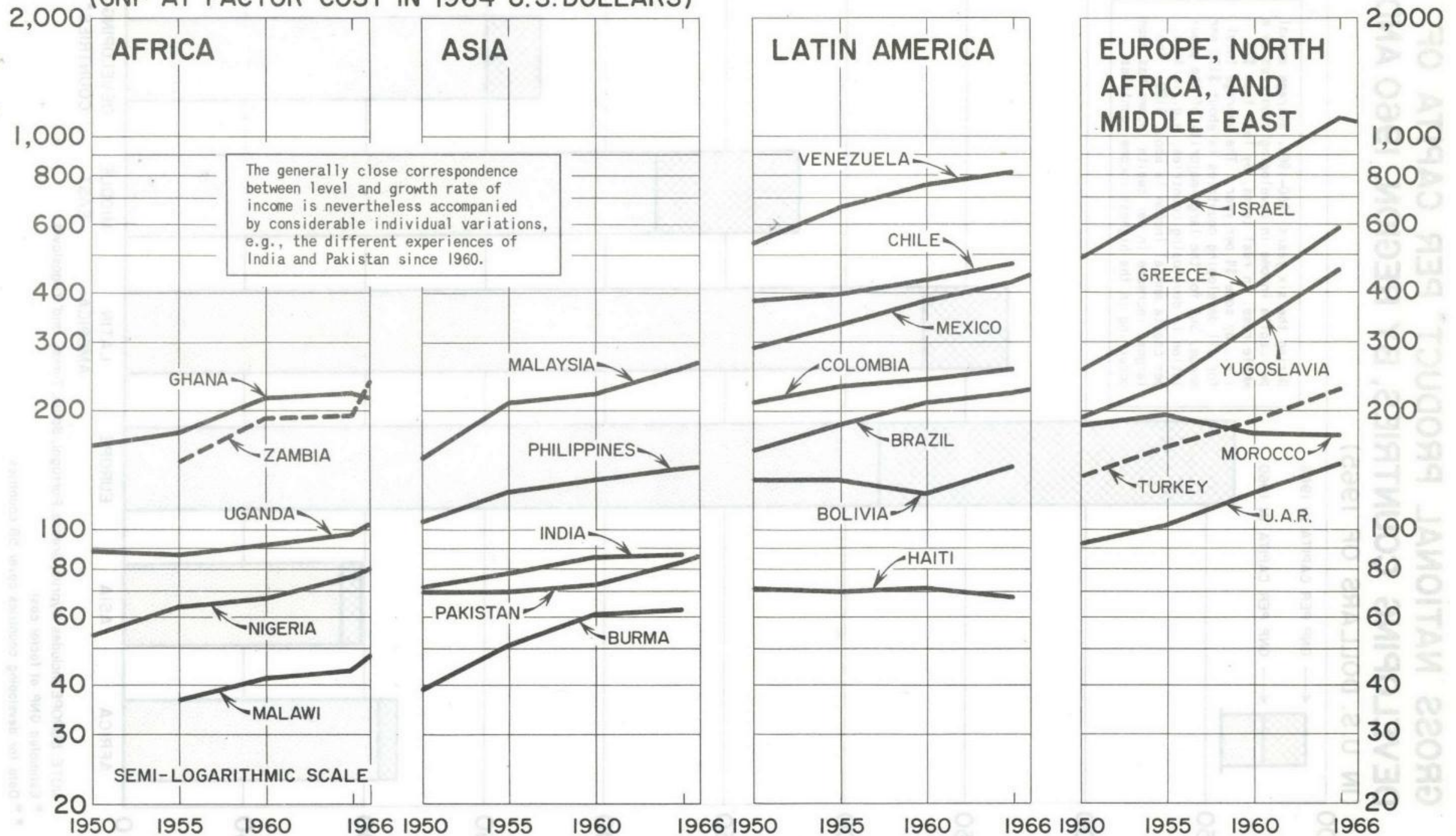
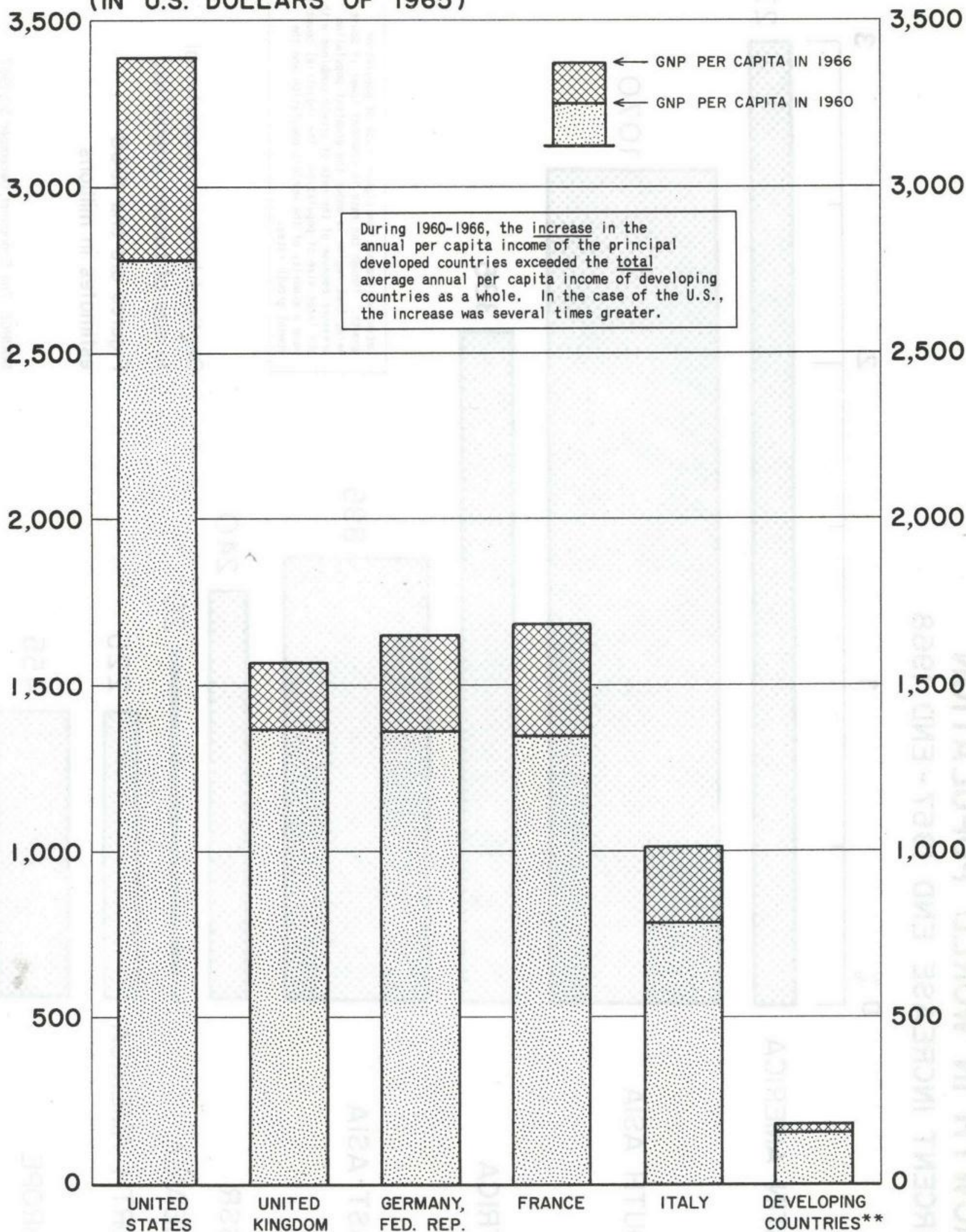


CHART 2



* Estimated GNP at factor cost.

** Data for developing countries cover 58 countries.

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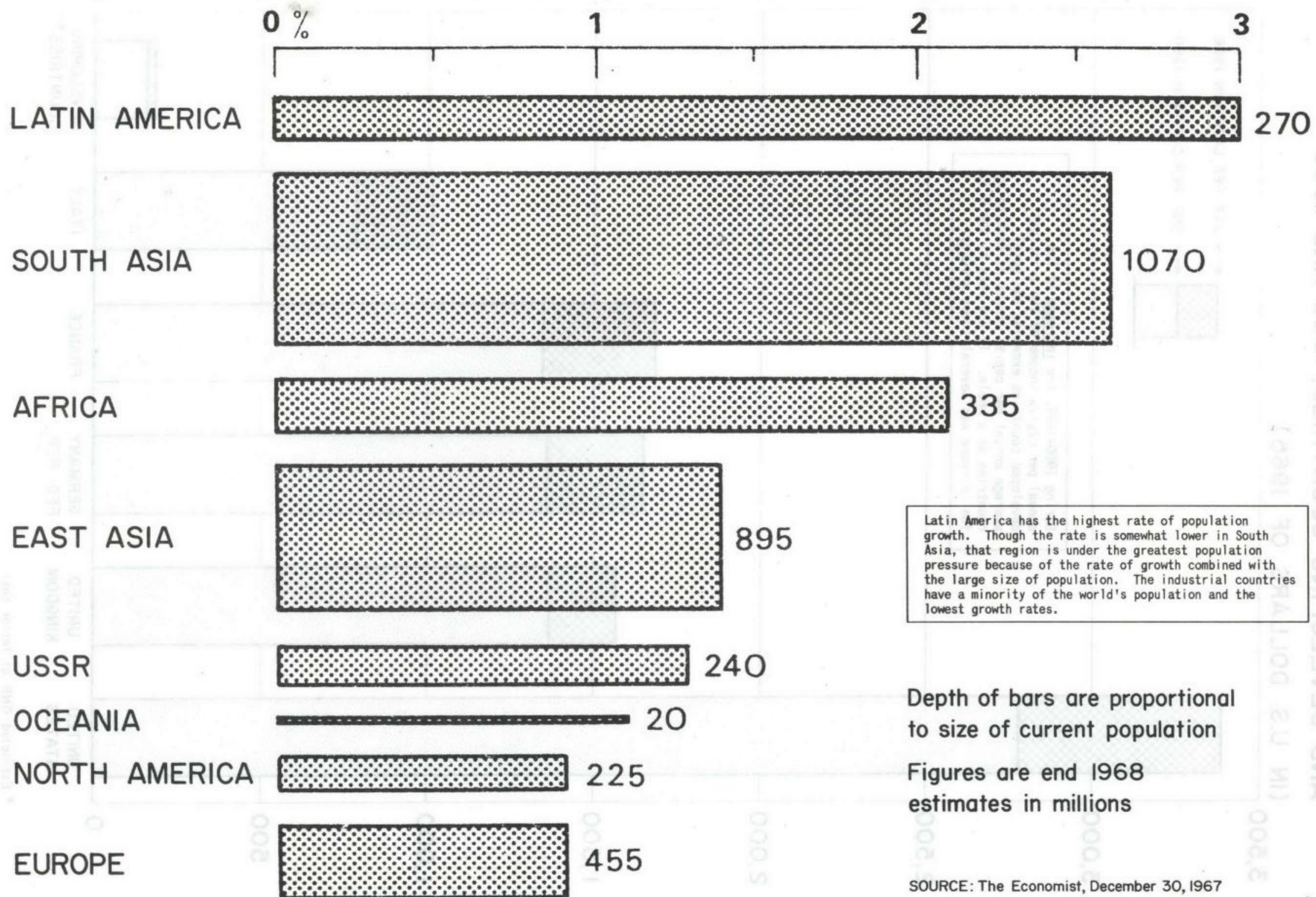
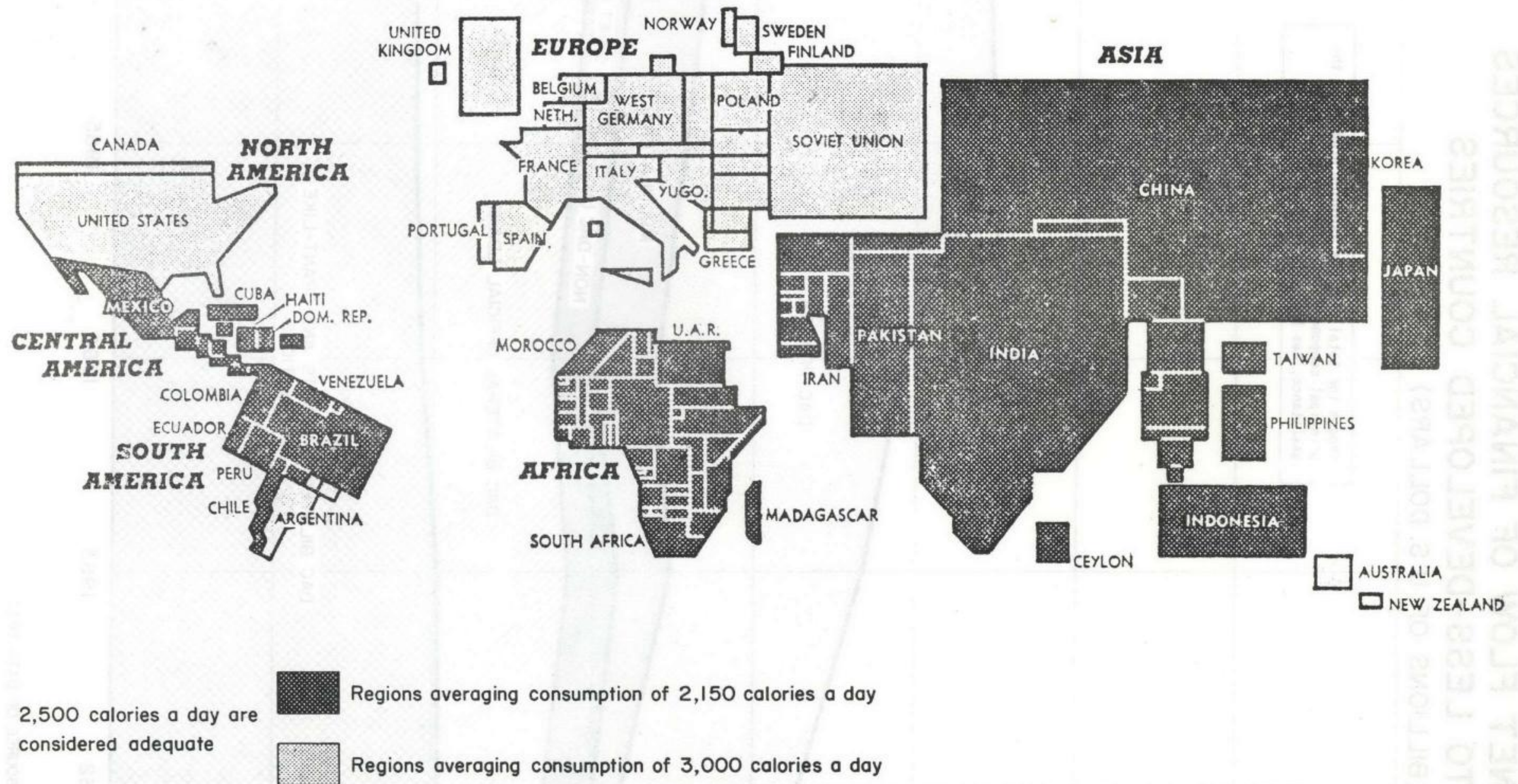


CHART 4

CALORIE INTAKE OF DEVELOPED AND DEVELOPING COUNTRIES

MUCH OF THE WORLD'S POPULATION IS HUNGRY



SOURCE: New York Times, January 1,1967; countries and territories shown in proportion to population based on a drawing by the Food and Agriculture Organization.

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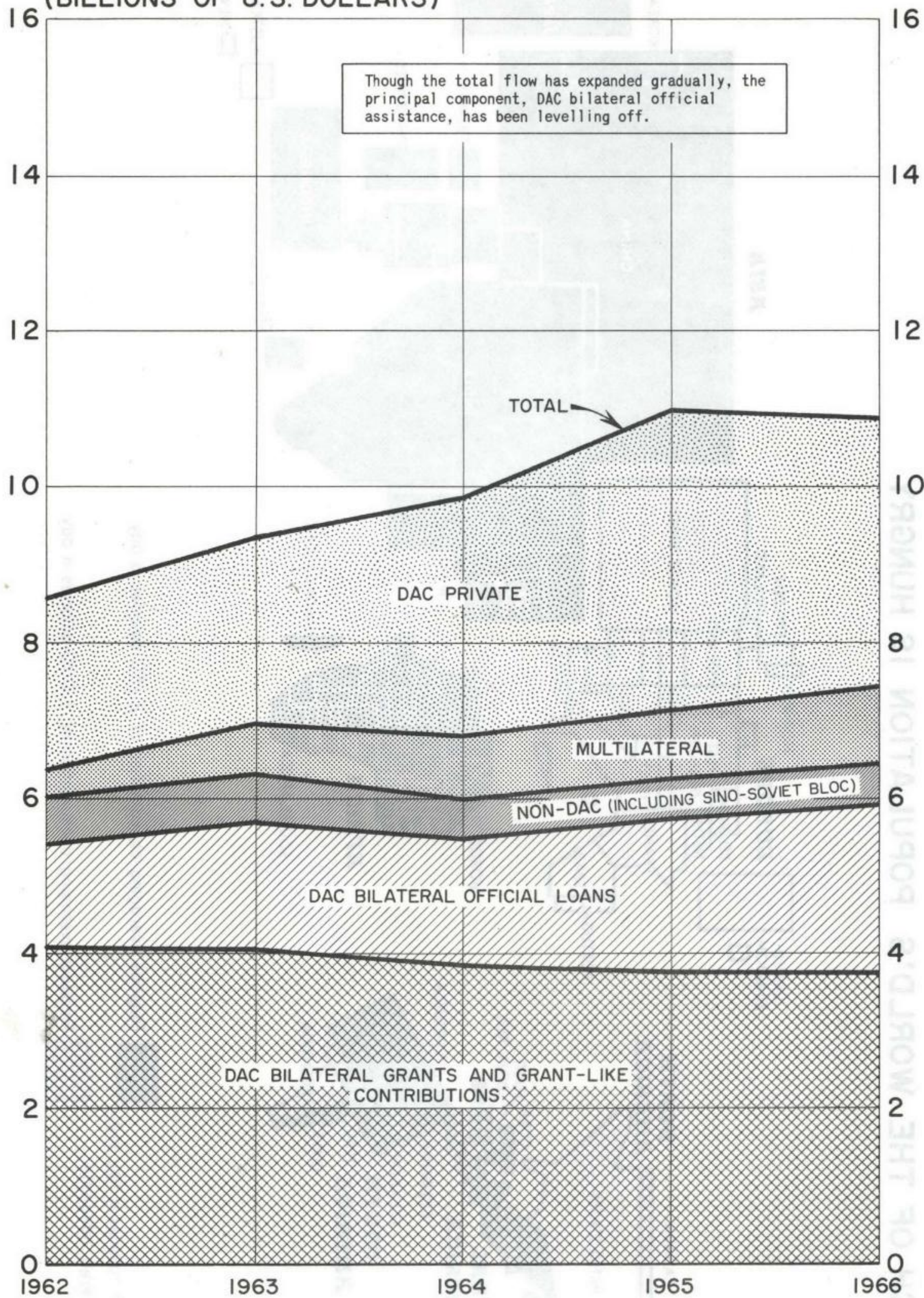
CHART 5

CHART 6

NET FLOW OF FINANCIAL RESOURCES TO LESS-DEVELOPED COUNTRIES

(BILLIONS OF U.S. DOLLARS)



SOURCE OF DATA: OECD

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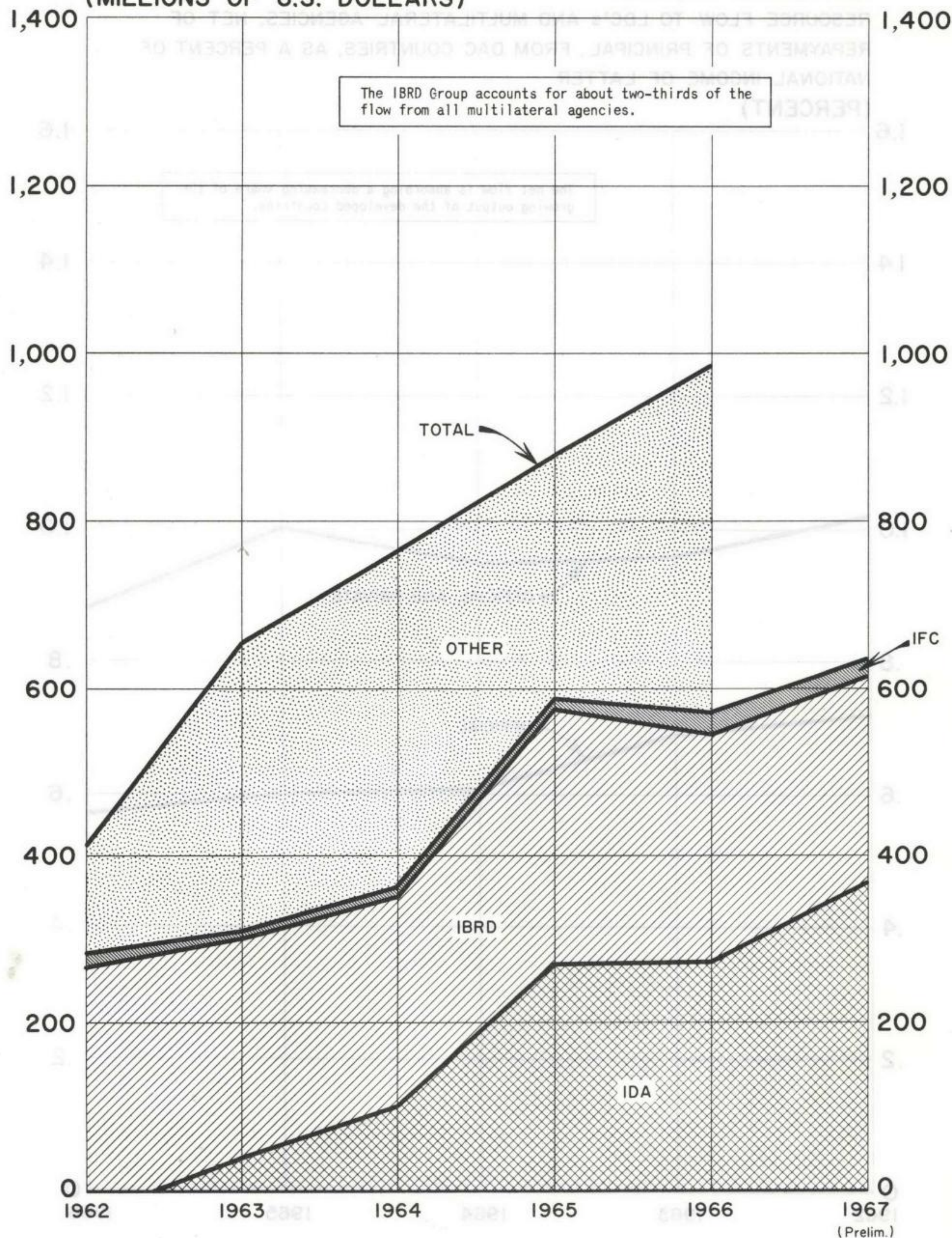
CHART 7



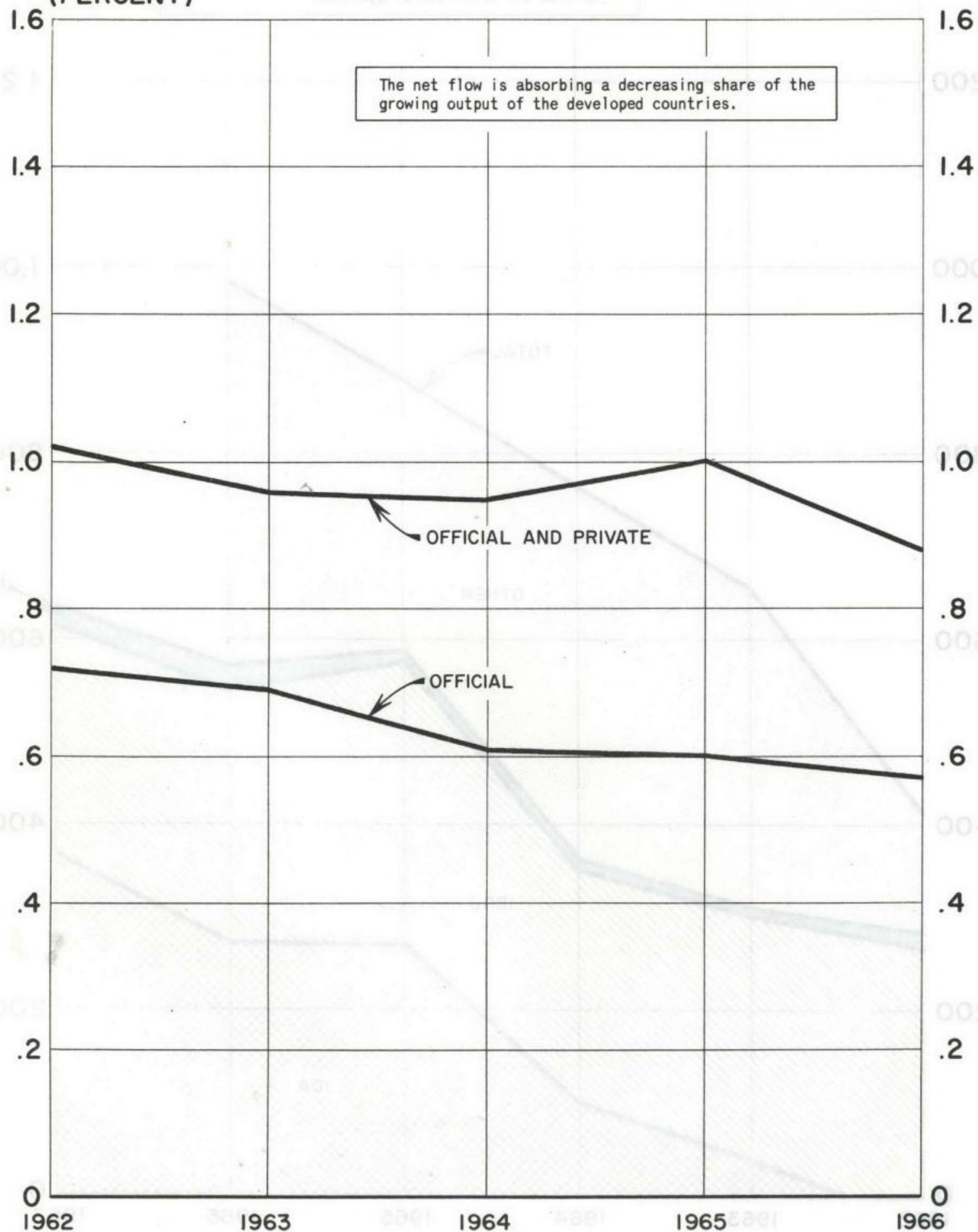
SOURCE OF DATA: OECD and IBRD

(R)IBRD-3787

NET FLOW OF FINANCIAL RESOURCES FROM DAC COUNTRIES COMBINED AS A PERCENTAGE OF NATIONAL INCOME

RESOURCE FLOW TO LDC's AND MULTILATERAL AGENCIES, NET OF REPAYMENTS OF PRINCIPAL, FROM DAC COUNTRIES, AS A PERCENT OF NATIONAL INCOME OF LATTER

(PERCENT)



SOURCE OF DATA: OECD

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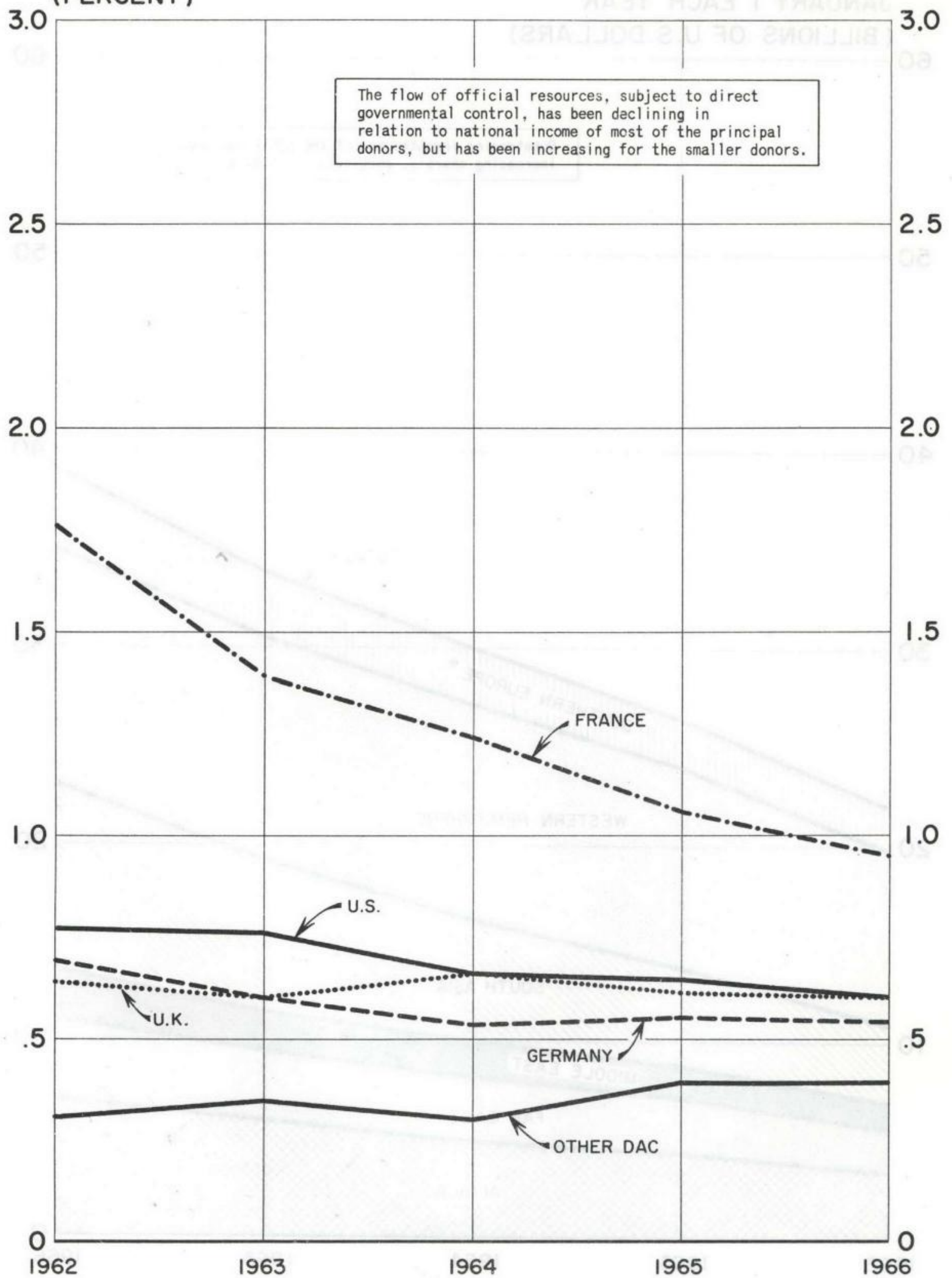

SOURCE OF DATA: OECD

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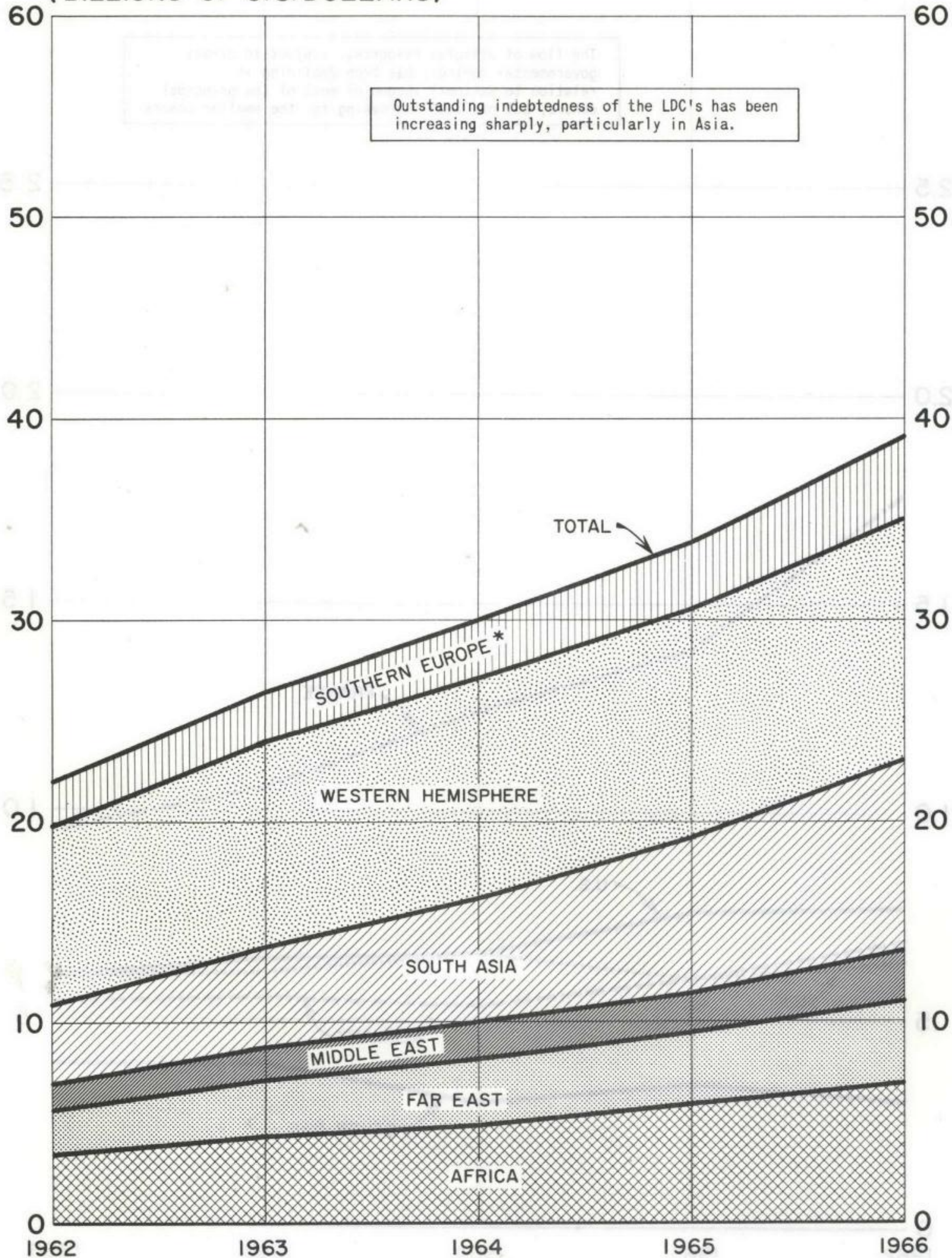
EXTERNAL PUBLIC DEBT OF LDC's

DEBTS OF LDC GOVERNMENTS, OR GUARANTEED BY THEM, OF MATURITY EXCEEDING 1 YEAR, INCLUDING UNDISBURSED, AS OF JANUARY 1 EACH YEAR

(BILLIONS OF U.S. DOLLARS)



* Cyprus, Greece, Malta, Spain, Turkey and Yugoslavia.

SOURCE OF DATA: IBRD

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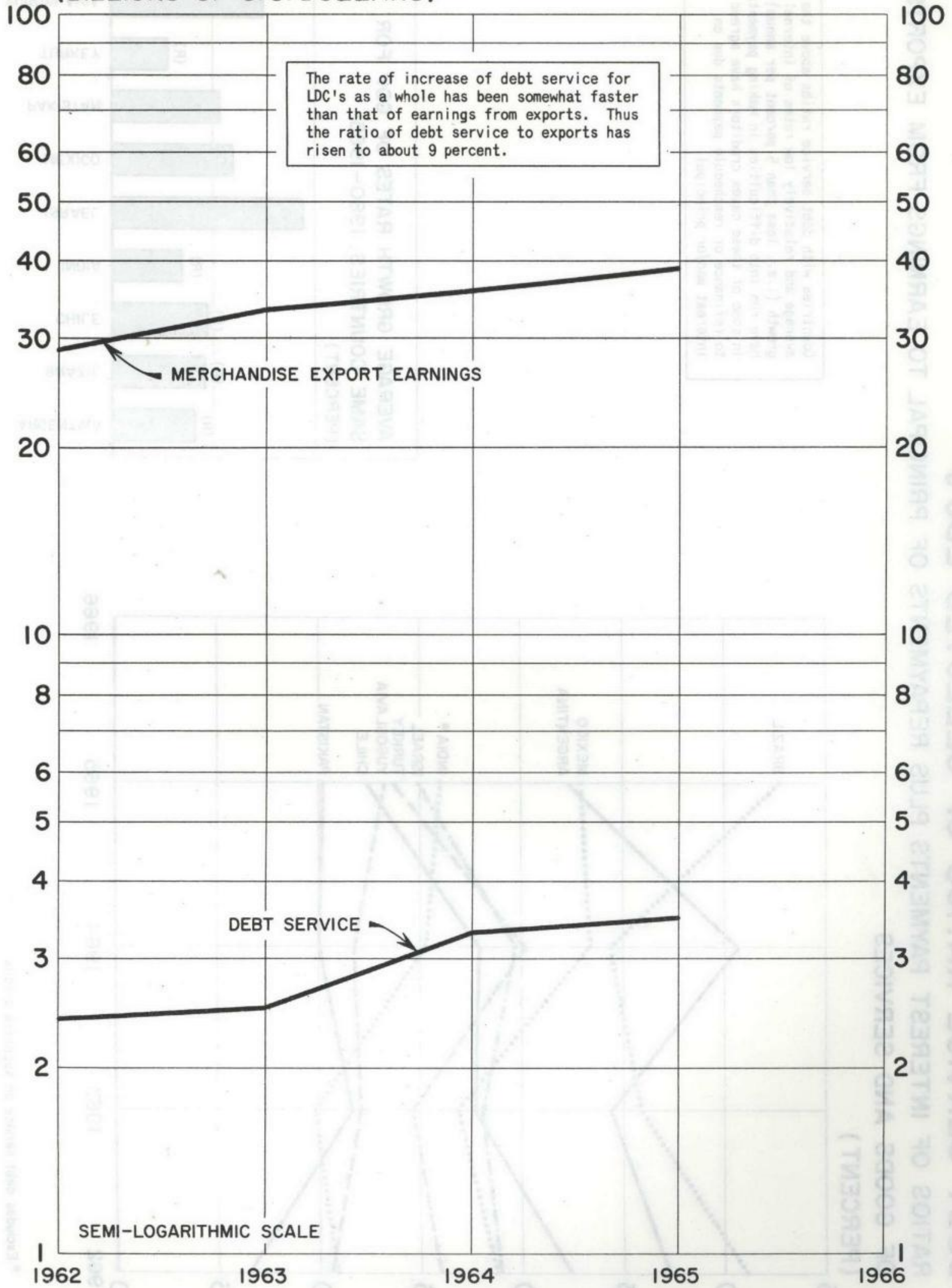

SOURCE OF DATA: IBRD

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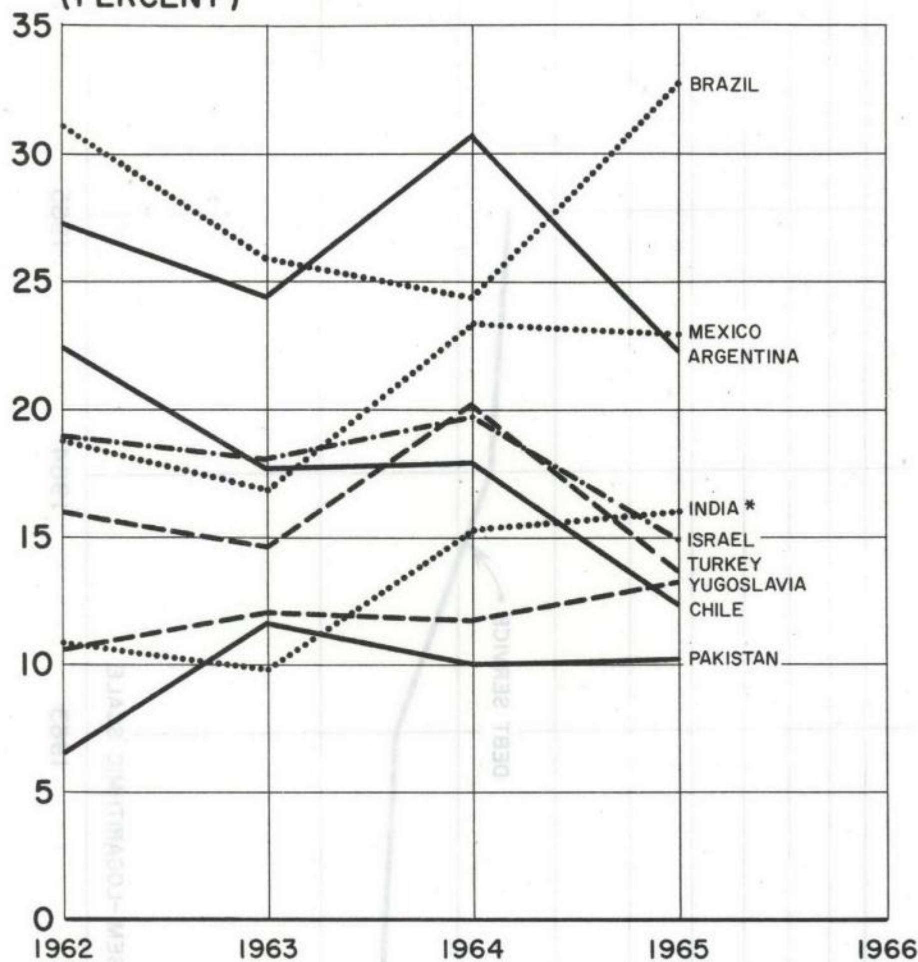
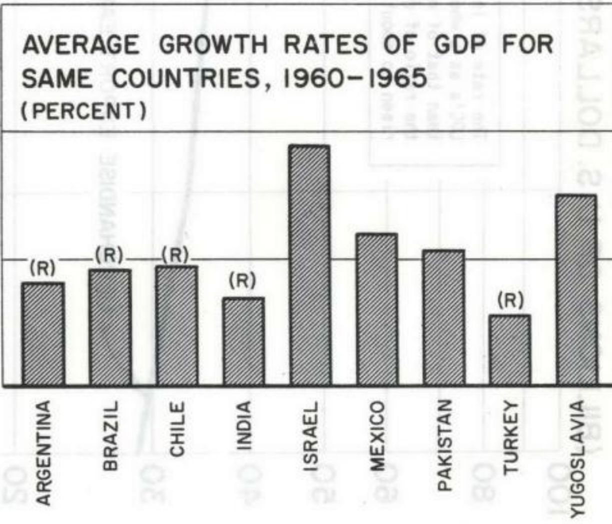
DEBT SERVICE RATIOS OF SELECTED LDC's

RATIOS OF INTEREST PAYMENTS PLUS REPAYMENTS OF PRINCIPAL TO EARNINGS FROM EXPORTS OF GOODS AND SERVICES

(PERCENT)



Countries with debt service ratios above the average and relatively low rates of internal growth (i.e., less than 5 percent per annum) have run into difficulties in making payments. In some of these cases creditors have agreed to refinance or reschedule payments due on interest and/or principal.



* Excludes debt service on suppliers credits.

SOURCE OF DATA: IBRD

(R) Denotes countries where debt service has been rescheduled.

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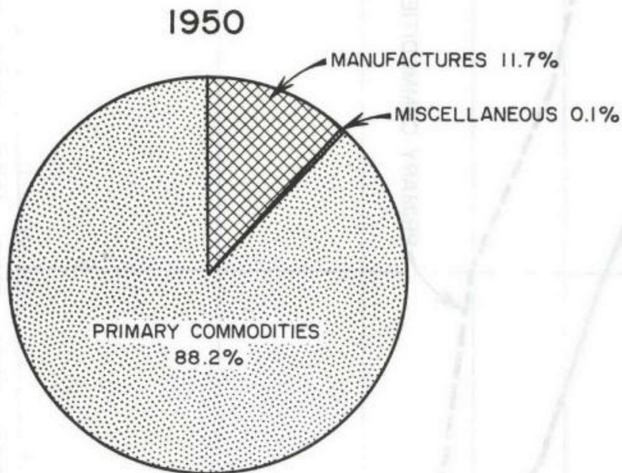
CHART 12

VALUE OF PRIMARY COMMODITIES AND MANUFACTURES AS A PERCENTAGE OF TOTAL EXPORTS

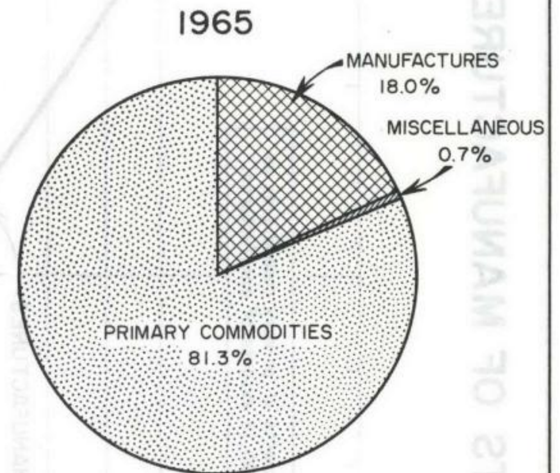
LDC's

1950



TOTAL: $ 18.3 BILLION

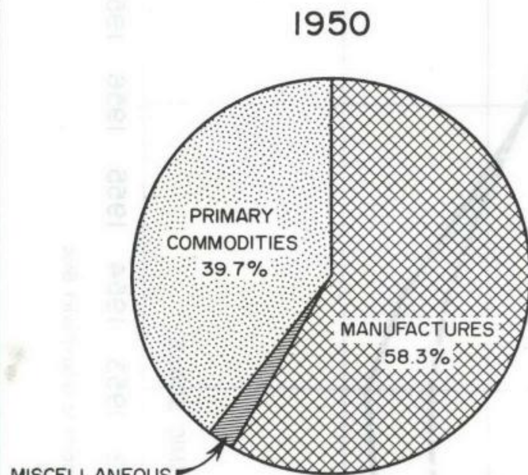
1965



TOTAL: $ 33.8 BILLION

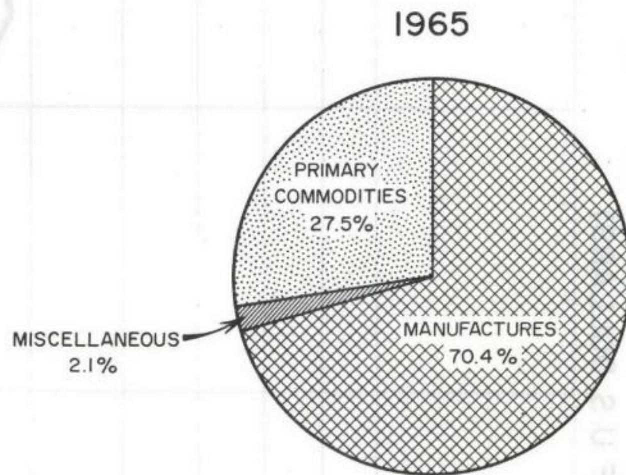
DEVELOPED COUNTRIES

1950



TOTAL: $ 35.7 BILLION

1965

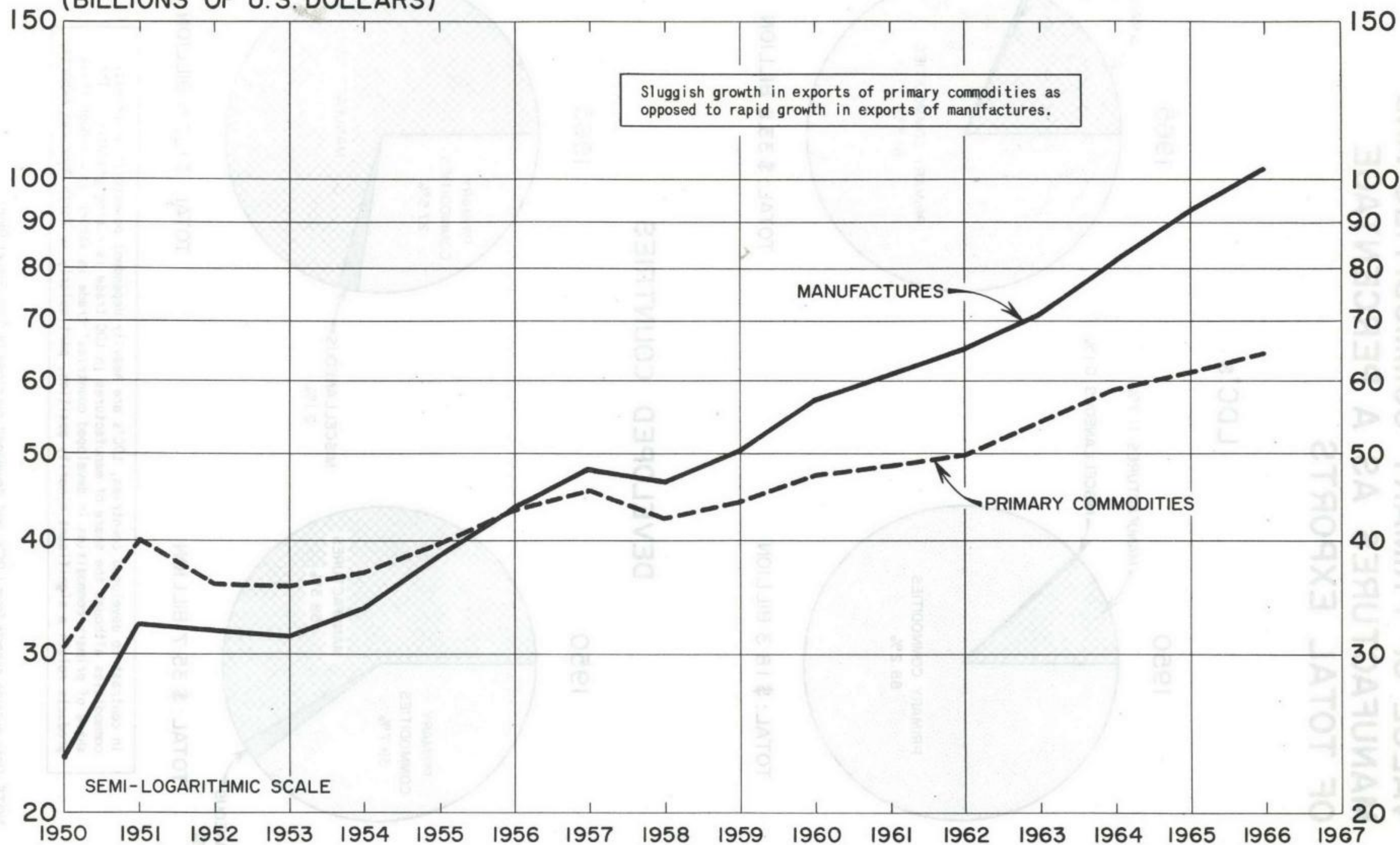


TOTAL: $ 122.5 BILLION

In contrast to developed countries, LDC's are heavily dependent on exports of primary commodities although the share of manufactures in LDC trade is rising gradually. The share of primary commodities in developed countries' trade is shrinking although these products retain a significant minority position, particularly in North American exports.

NOTE: Data exclude exports from LDC's and developed countries to Sino-Soviet Bloc.
SOURCE OF DATA: UN

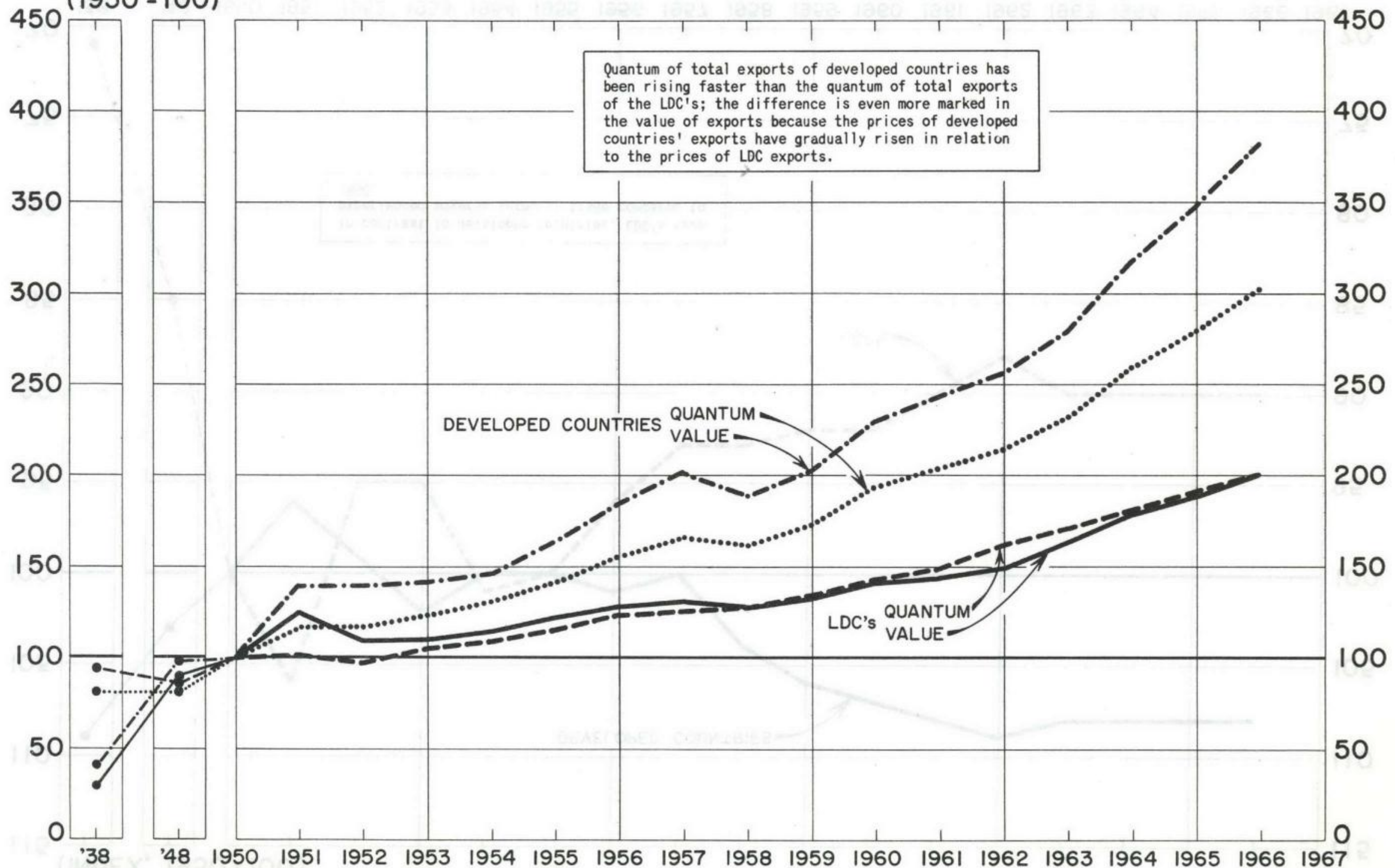
IBRD-3793

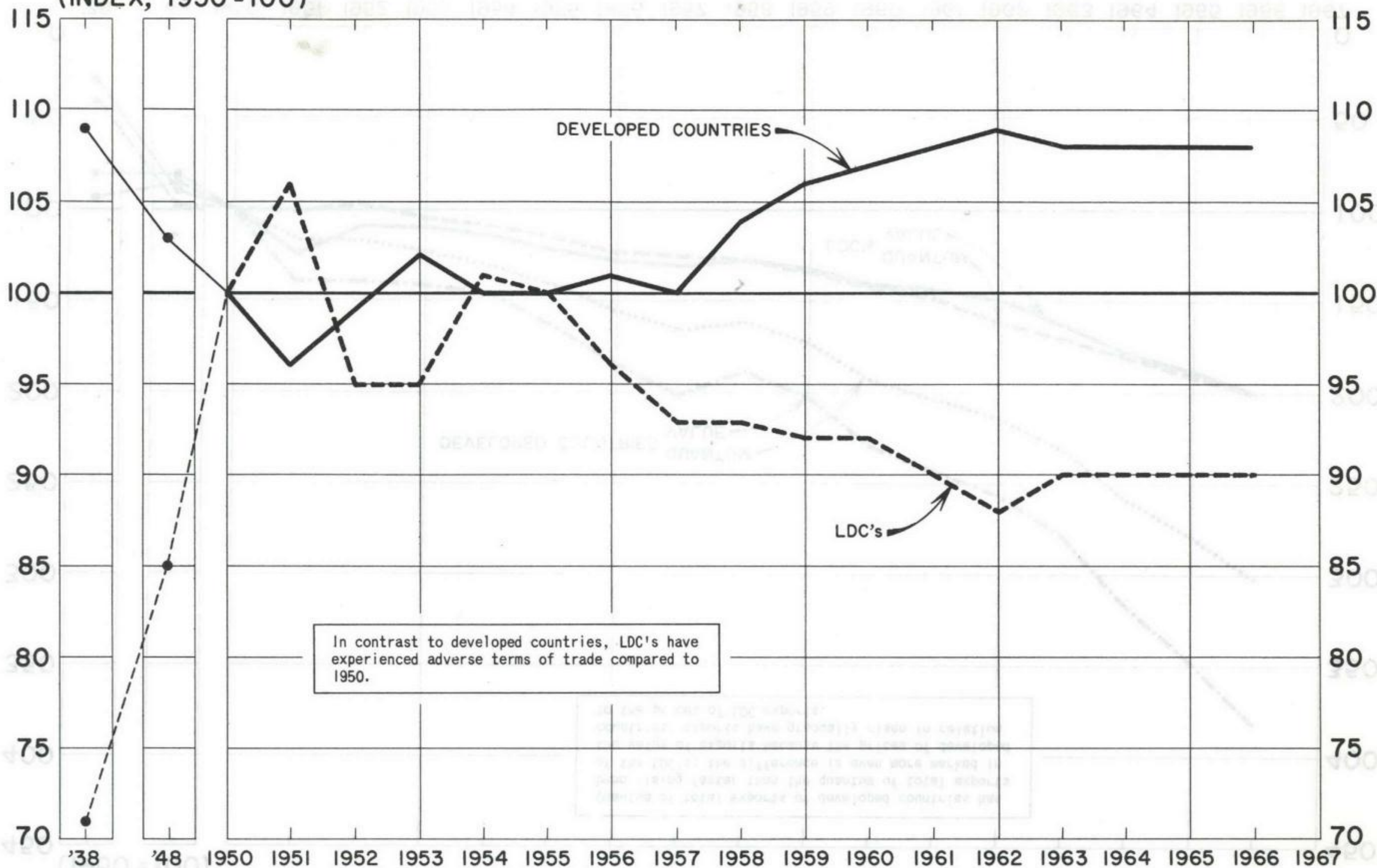


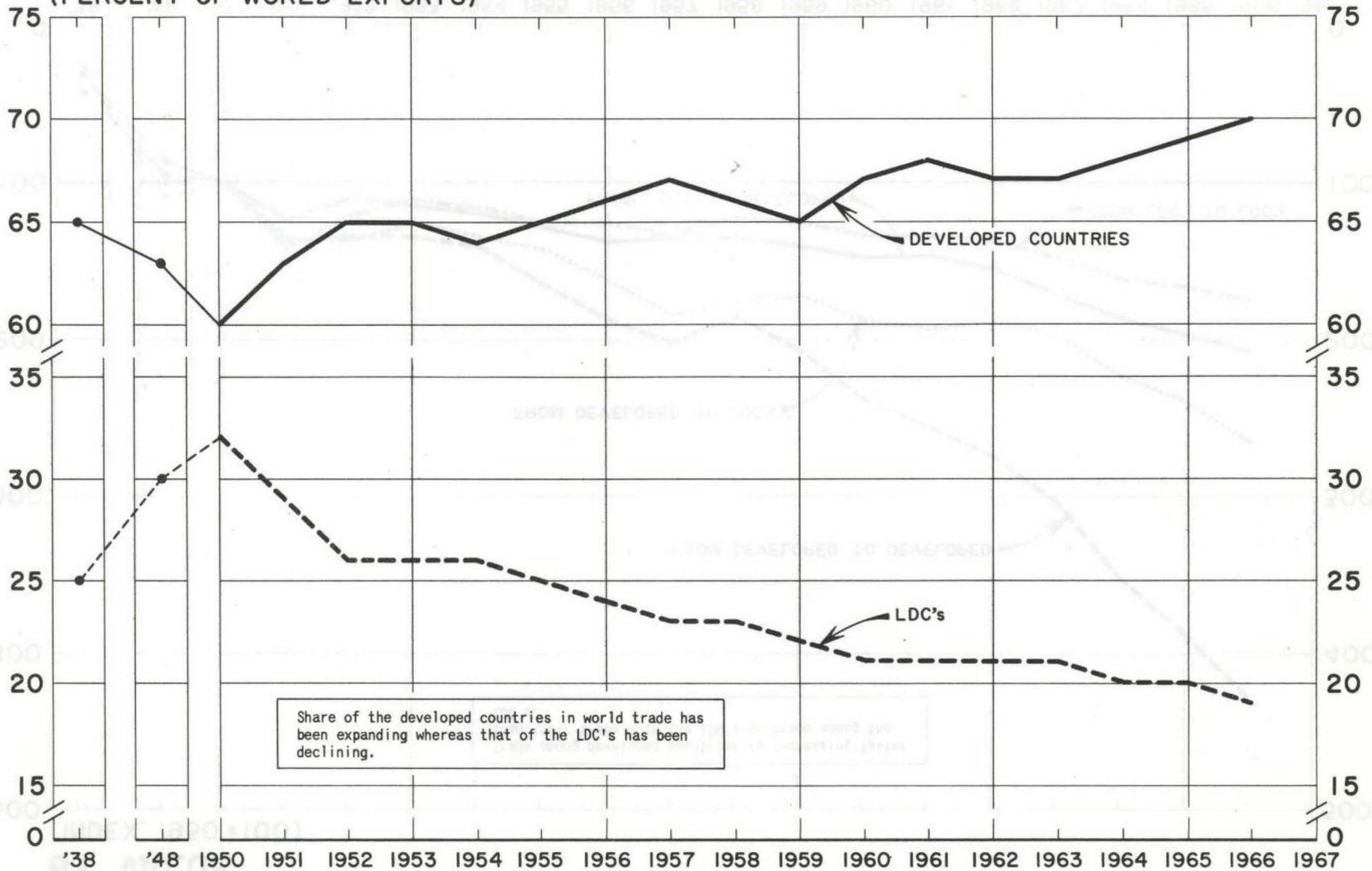
NOTE: Data exclude exports to Sino-Soviet Bloc.
SOURCE OF DATA: UN

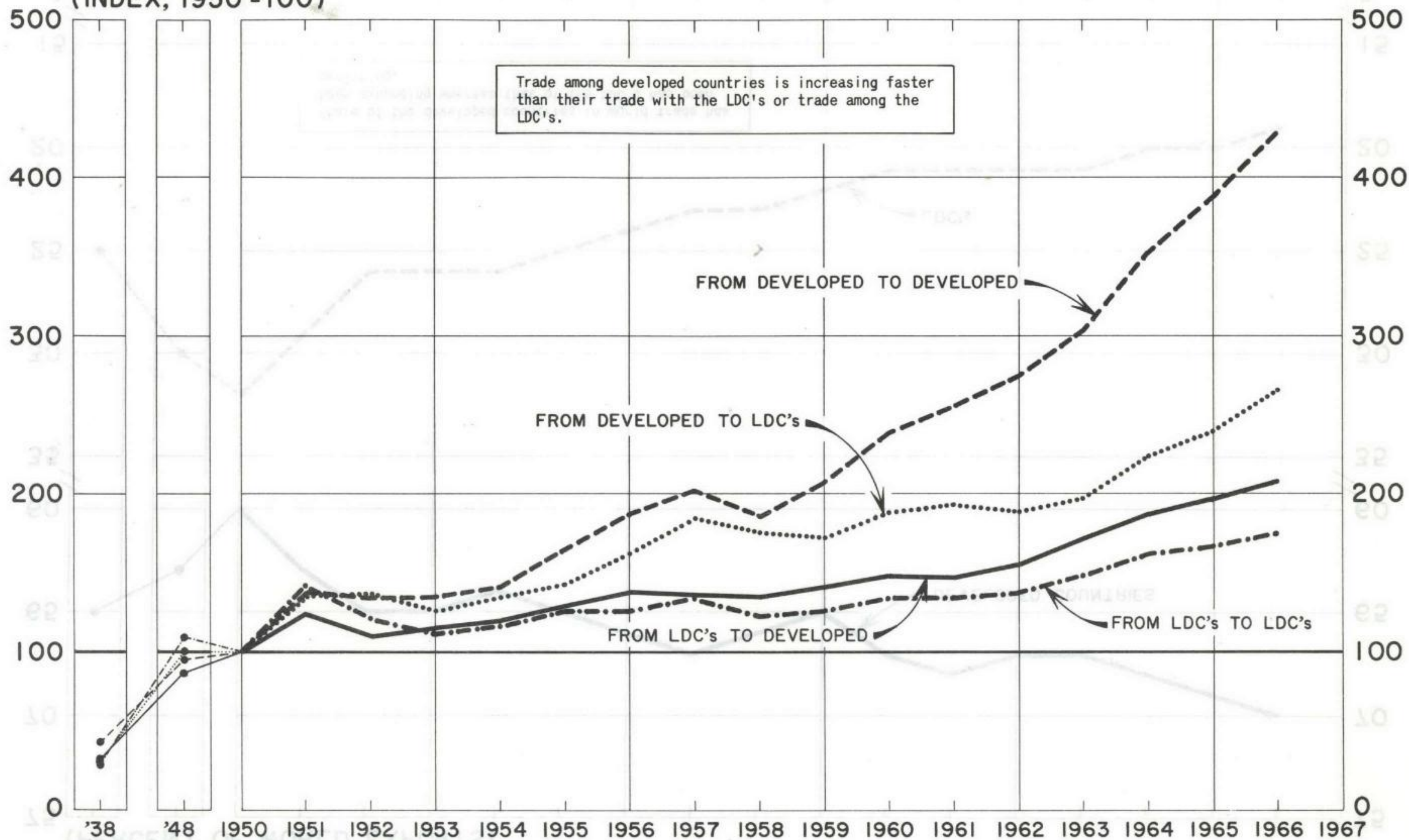
IBRD-3794

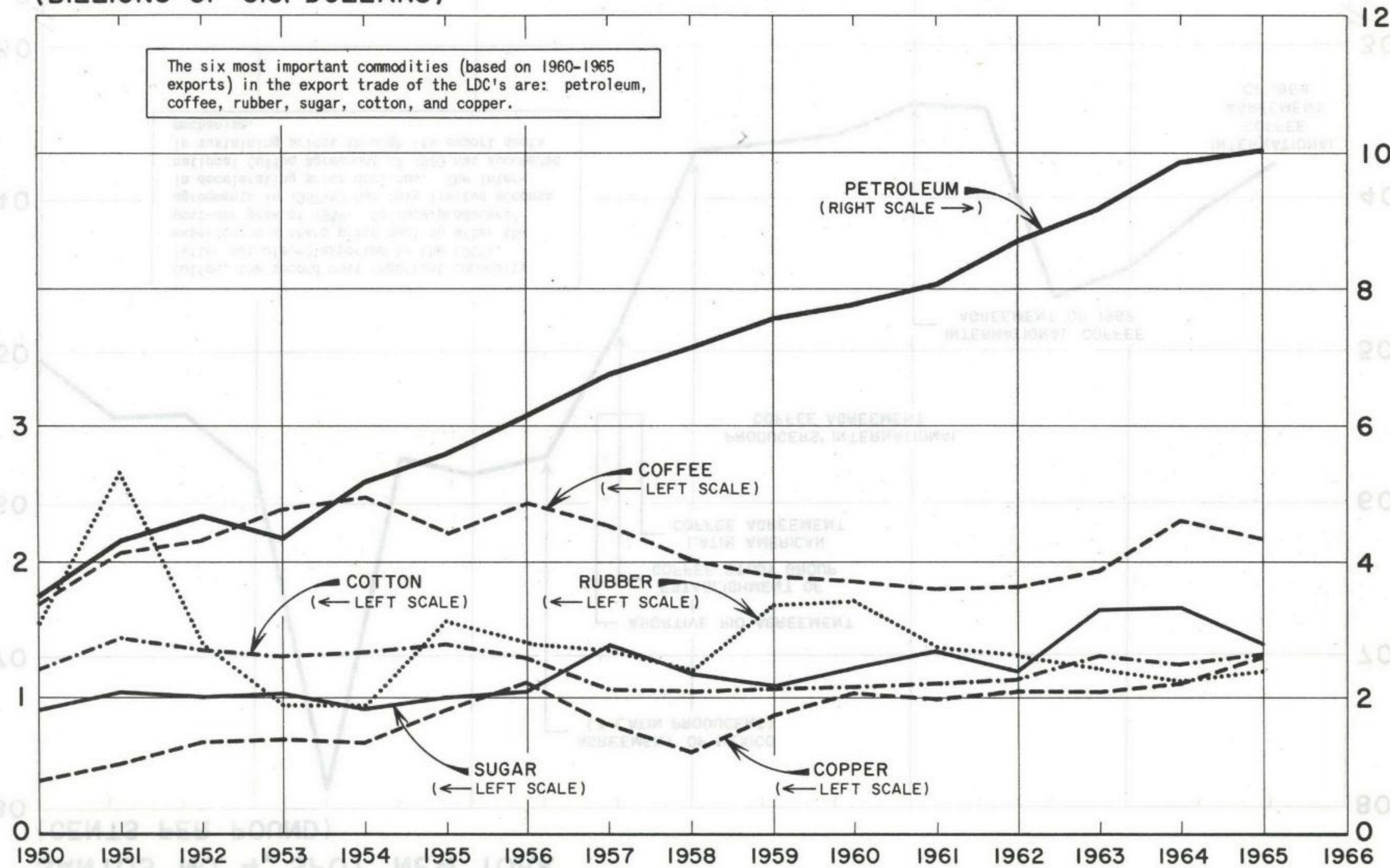
CHART 14


QUANTUM AND VALUE EXPORT INDICES
(1950 = 100)
Quantum of total exports of developed countries has been rising faster than the quantum of total exports of the LDC's; the difference is even more marked in the value of exports because the prices of developed countries' exports have gradually risen in relation to the prices of LDC exports.
DEVELOPED COUNTRIES QUANTUM
VALUE
LDC's QUANTUM
VALUE
450
400
350
300
250
200
150
100
50
0
'38 '48 1950 1951 1952 1953 1954 1955 1956 1957 1958 1959 1960 1961 1962 1963 1964 1965 1966 1967
SOURCE OF DATA: UN
IBRD-3795
CHART 15


TERMS OF TRADE
(INDEX, 1950=100)
115
110
105
100
95
90
85
80
75
70
'38
'48
1950
1951
1952
1953
1954
1955
1956
1957
1958
1959
1960
1961
1962
1963
1964
1965
1966
1967
DEVELOPED COUNTRIES
LDC's
In contrast to developed countries, LDC's have experienced adverse terms of trade compared to 1950.
SOURCE OF DATA: UN
(R) IBRD-3796
CHART 16


SHARE OF DEVELOPED COUNTRIES AND LDC's IN WORLD EXPORTS
(PERCENT OF WORLD EXPORTS)
75
70
65
60
35
30
25
20
15
0
DEVELOPED COUNTRIES
LDC's
Share of the developed countries in world trade has been expanding whereas that of the LDC's has been declining.
'38
'48
1950
1951
1952
1953
1954
1955
1956
1957
1958
1959
1960
1961
1962
1963
1964
1965
1966
1967
SOURCE OF DATA: UN
IBRD-3797
CHART 17


DIRECTION OF EXPORTS OF LDC's AND OF DEVELOPED COUNTRIES, BY VALUE
(INDEX, 1950 = 100)
Trade among developed countries is increasing faster than their trade with the LDC's or trade among the LDC's.
FROM DEVELOPED TO DEVELOPED
FROM DEVELOPED TO LDC's
FROM LDC's TO DEVELOPED
FROM LDC's TO LDC's
500
400
300
200
100
0
'38
'48
1950
1951
1952
1953
1954
1955
1956
1957
1958
1959
1960
1961
1962
1963
1964
1965
1966
1967
SOURCE OF DATA: UN
IBRD-3798
CHART 18


VALUE OF SIX MOST IMPORTANT COMMODITIES (IN 1960-1965) EXPORTED BY THE LDC's
(BILLIONS OF U.S. DOLLARS)
The six most important commodities (based on 1960-1965 exports) in the export trade of the LDC's are: petroleum, coffee, rubber, sugar, cotton, and copper.
PETROLEUM (RIGHT SCALE →)
COFFEE (← LEFT SCALE)
COTTON (← LEFT SCALE)
RUBBER (← LEFT SCALE)
SUGAR (← LEFT SCALE)
COPPER (← LEFT SCALE)
0
1
2
3
0
2
4
6
8
10
12
1950
1951
1952
1953
1954
1955
1956
1957
1958
1959
1960
1961
1962
1963
1964
1965
1966
SOURCE OF DATA: IBRD
IBRD-3799
CHART 19

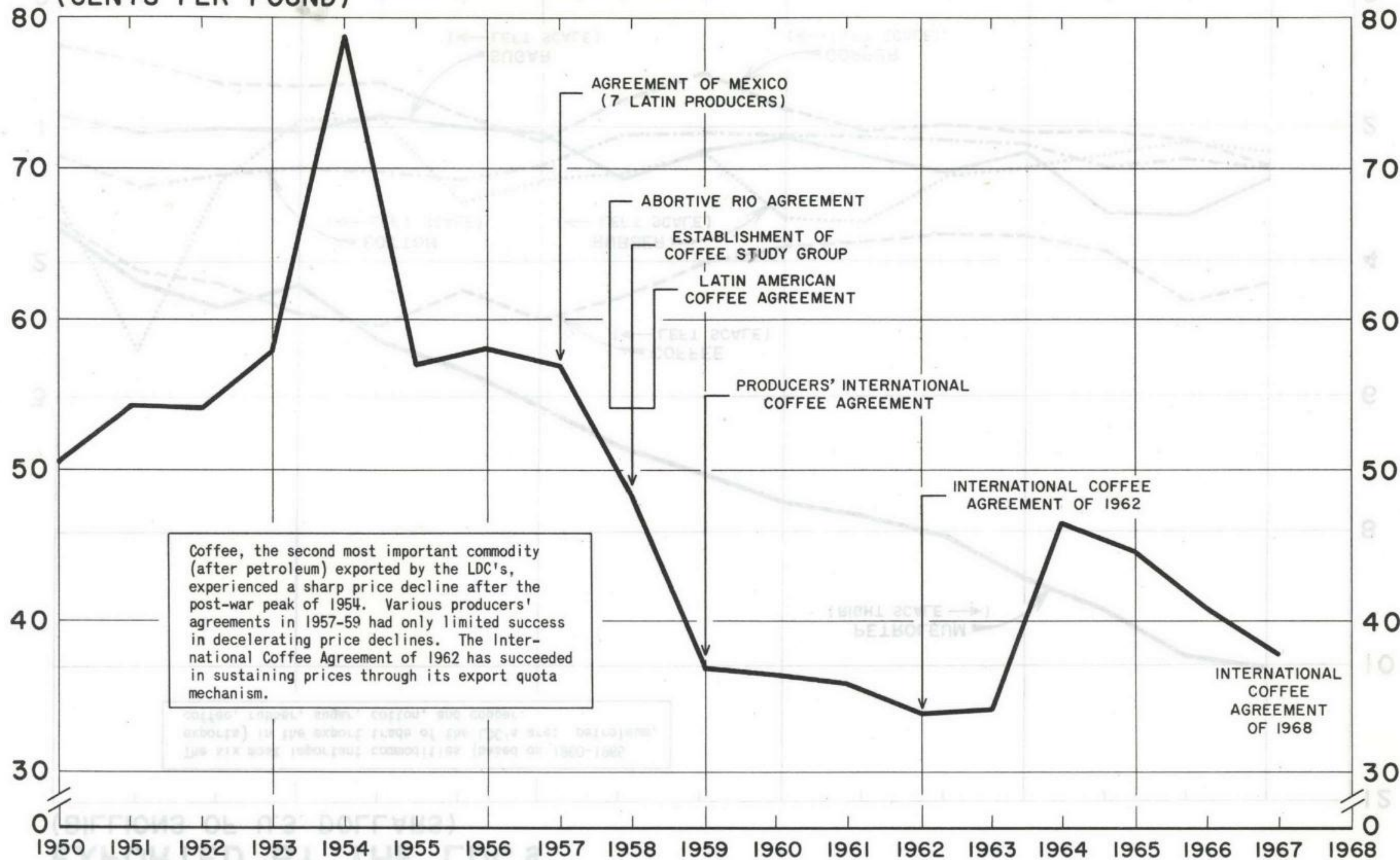


CHART 20

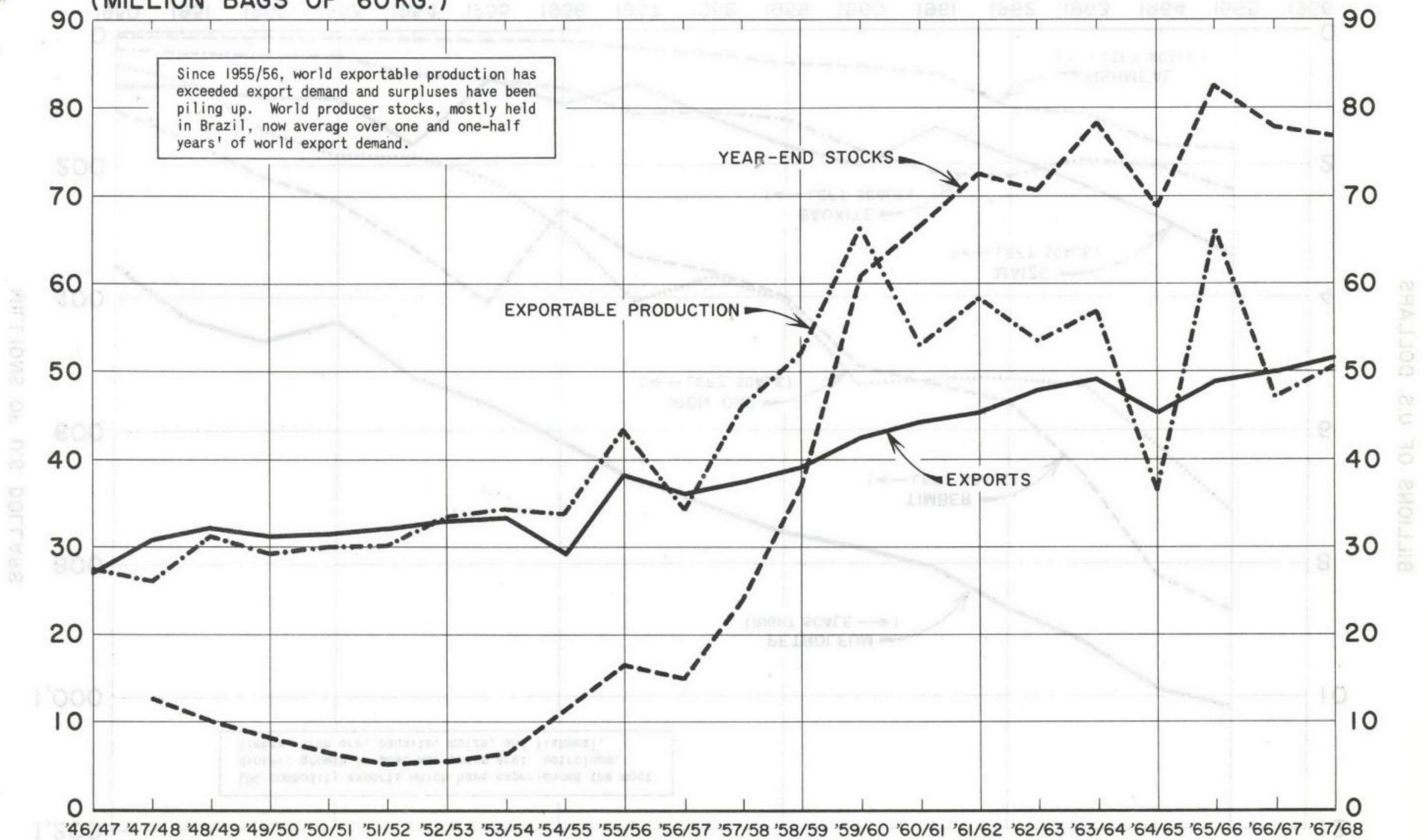


CHART 21

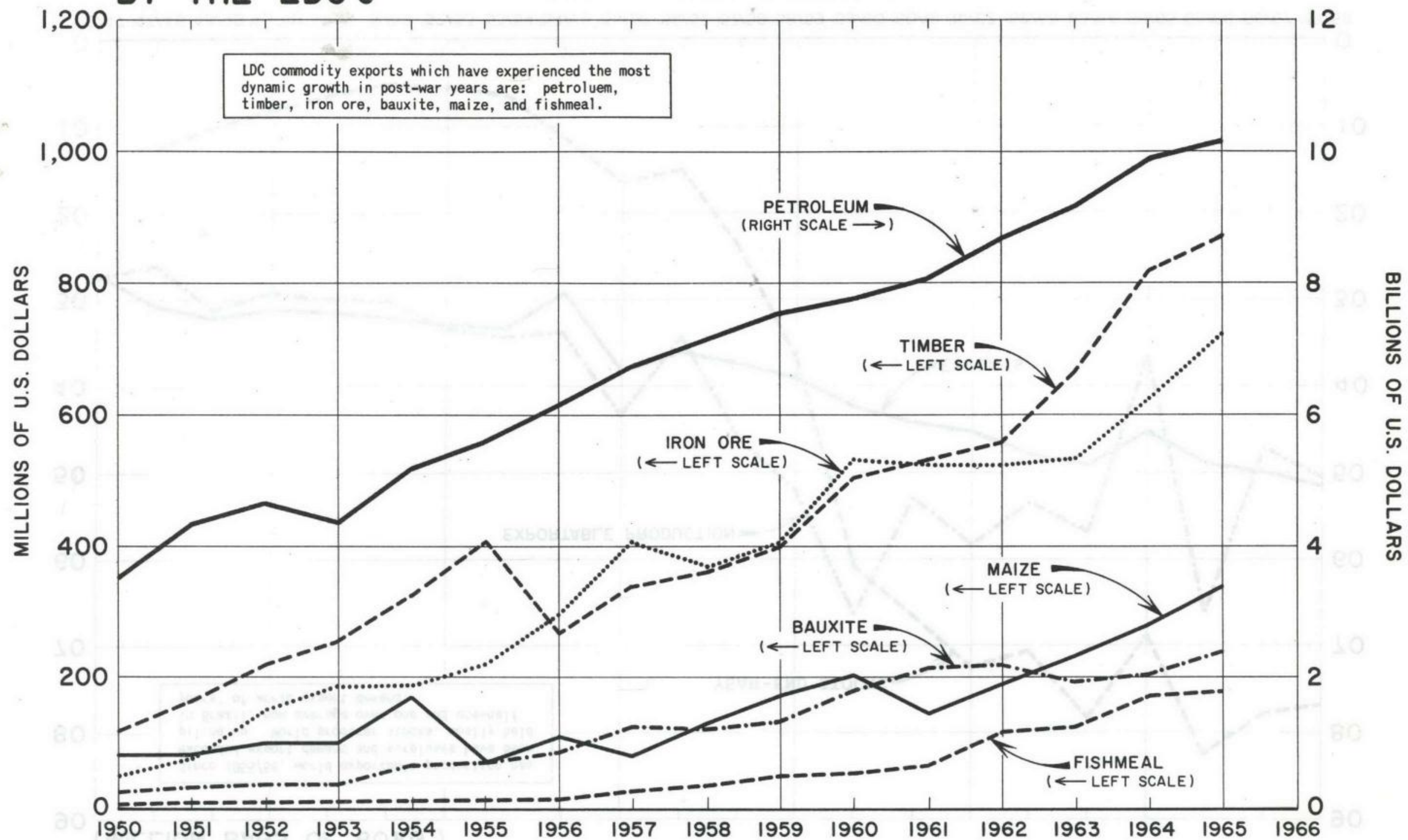
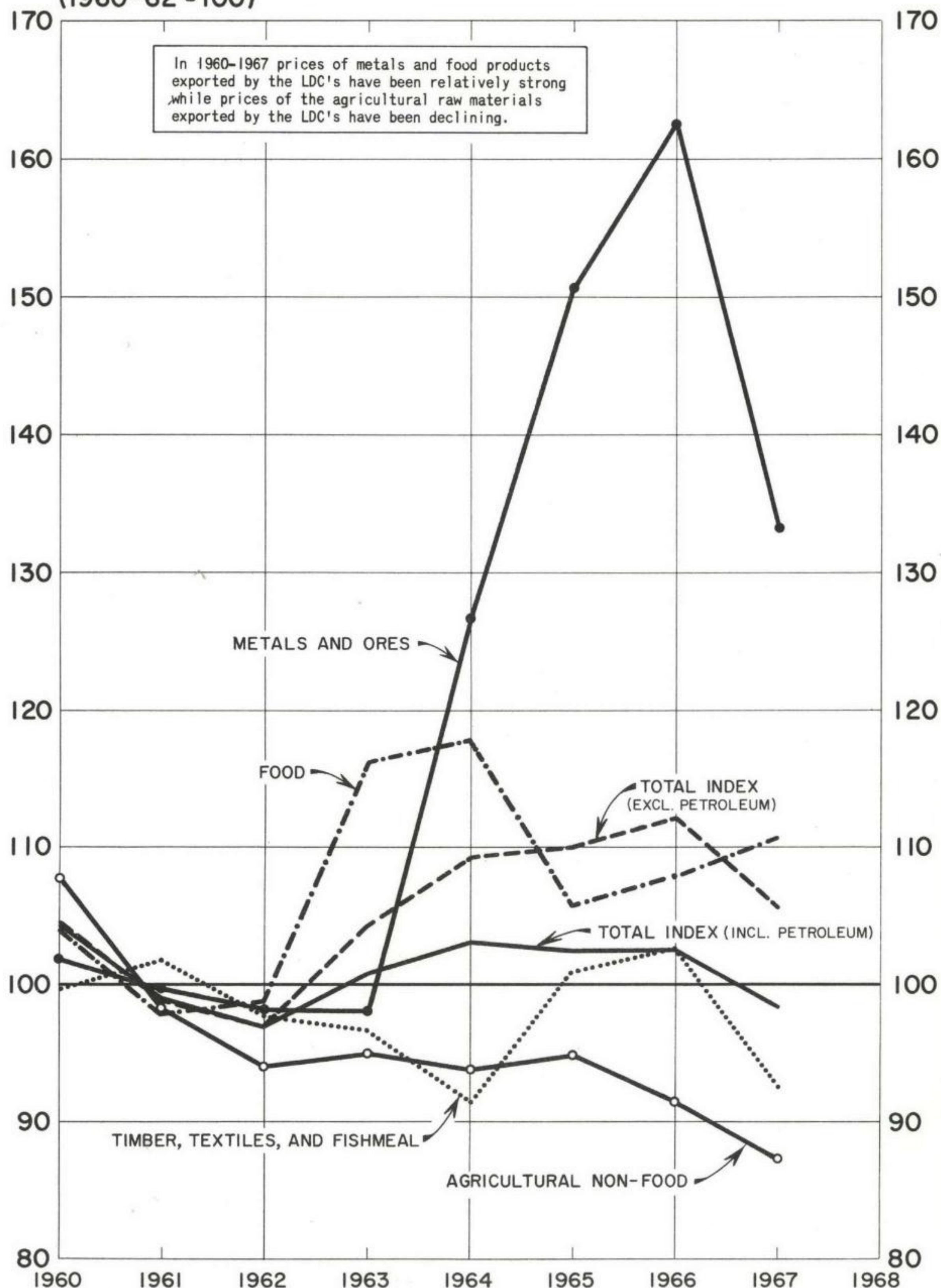


CHART 22



NOTE: Index constructed by IBRD Export Projections and Trade Division; weights based on LDC exports.

IBRD-3803

Filed Speech BK. Talk given by Mr Friedman at Symposium sponsored by the Electronics Research Center, NASA/MIT, Cambridge, Mass, Feb 10, 1969

WORLD BANK OPERATIONS IN THE LESS-DEVELOPED COUNTRIES

Irving S. Friedman
The Economic Advisor to the President
International Bank for Reconstruction and Development
Washington, D.C.

* * * * *

Author Profile

Irving S. Friedman became the Economic Advisor to the President of the World Bank in 1964. He is in charge of activities and policies related to development finance. A Columbia University Ph.D., Friedman was active in the international discussions that eventually led to the formation of the World Bank and the International Monetary Fund. He joined the Fund in 1946, serving as Chief of the United States-Canada Division and, later, as assistant for policy matters to the Deputy Managing Director. Prior to joining the World Bank, he was Director of the Exchange Restrictions Department of the International Monetary Fund, a position he held for 14 years. The economic problems of the less-developed nations form one of Friedman's most important areas of interest.

Irving S. Friedman

* * * * *

When I was asked to talk at this symposium, I told the Seminar Chairman that I was no expert in control theory; and it just seemed to be a little unfair to impose a non-expert in control theory on such a distinguished audience. I was told that an expert in control theory from the World Bank was not expected, but that the people working in control theory and in its various applications would be interested in the international scene and the World Bank as seen by an economist. The Chairman felt that perhaps I might indicate the kinds of problems that exist on the world scene which might not be so obvious to all of you, depending upon your particular preoccupation.

THE JOB OF THE WORLD BANK

The job of the World Bank is really concerned with the poorer countries, that is, with the less-developed countries. Our job at the Bank is to define the problems, to establish the goals, and

to find and finance solutions in the fields of economic and social development in these poorer countries.

Normally, if you speak to development economists, they will speak in terms of maximizing output by maximizing the mobilization of resources and optimizing the utilization of the allocation of resources. This is, in general, what we try to do. But, as I see it, the emphasis is really on how we achieve a greater application of modern technology to the problems of the less-developed countries, using "technology" of course in the broadest sense of the word. It is obvious from this symposium that you take a very broad concept of technology.

Our job is to change current trends so that the gloomy forecasts of the world's future will not materialize. To me this is the essence of our problem. Our standard technique is to maximize the mobilization of resources and optimize their utilization. But in the real world we often have to be satisfied with less than the optimum.

When we look at what is happening in the less developed world, we make a subjective judgment--a judgment which we really can't prove in the end--that if current trends based upon the best forecasting techniques continue, we'll have a world that is simply unacceptable to people, say, 25, 30, or 50 years from now. The Bank, therefore, plays a major role in changing these trends; therefore, we have an interest in understanding the world economy as well as we know how--not because of a desire to understand its intricacies or to forecast better, but because we don't like the way this economy operates in the less-developed world and we want to make it operate differently.

I honestly don't know how much people here know about the less-developed world--I don't know whether you know what the World Bank is--so let me be panoramic and survey what is happening in the less-developed world.

PANORAMIC LOOK AT THE LESS-DEVELOPED COUNTRIES

In the first place, the growth rates of gross national products (Figures 1 and 2) have been about 4-1/2 to 5 percent a year. As I'm sure most of you know, these are actually more rapid rates of growth than those experienced by the developed countries--Western Europe, Canada, the United States, Australia, New Zealand, and Japan. But one of the problems with the growth-rate statistic in the less-developed world is that we don't really understand what it means. We don't know whether growth and development are the same thing. (I believe they are not.) If you measure the increments in output from year to year, exactly what are you measuring if you're looking down the road to the year 2000? We often find these growth rates to be temporary. At times, we find the resource allocations that resulted in these growth rates were inefficient. Most important of all, we find that these increments in growth do not result in an increase of living standards for the great masses of the populations of these countries.

In terms of living standards, the gross national product seems to have little impact on the living standards of countries. This gives us a clue. First, let me point to population growth. The population growth in these countries varies from about 2 to 4 percent per annum. In Latin America it ranges over 3 percent per annum, if you exclude Argentina and Chile. So, you have a 4 to 5 percent growth rate, but at the same time you have a population growth rate in many countries of 2 to 3 or even 3.5 percent a year. It becomes clear that in terms of living standards, this means that the amounts available for increased consumption are very small indeed.

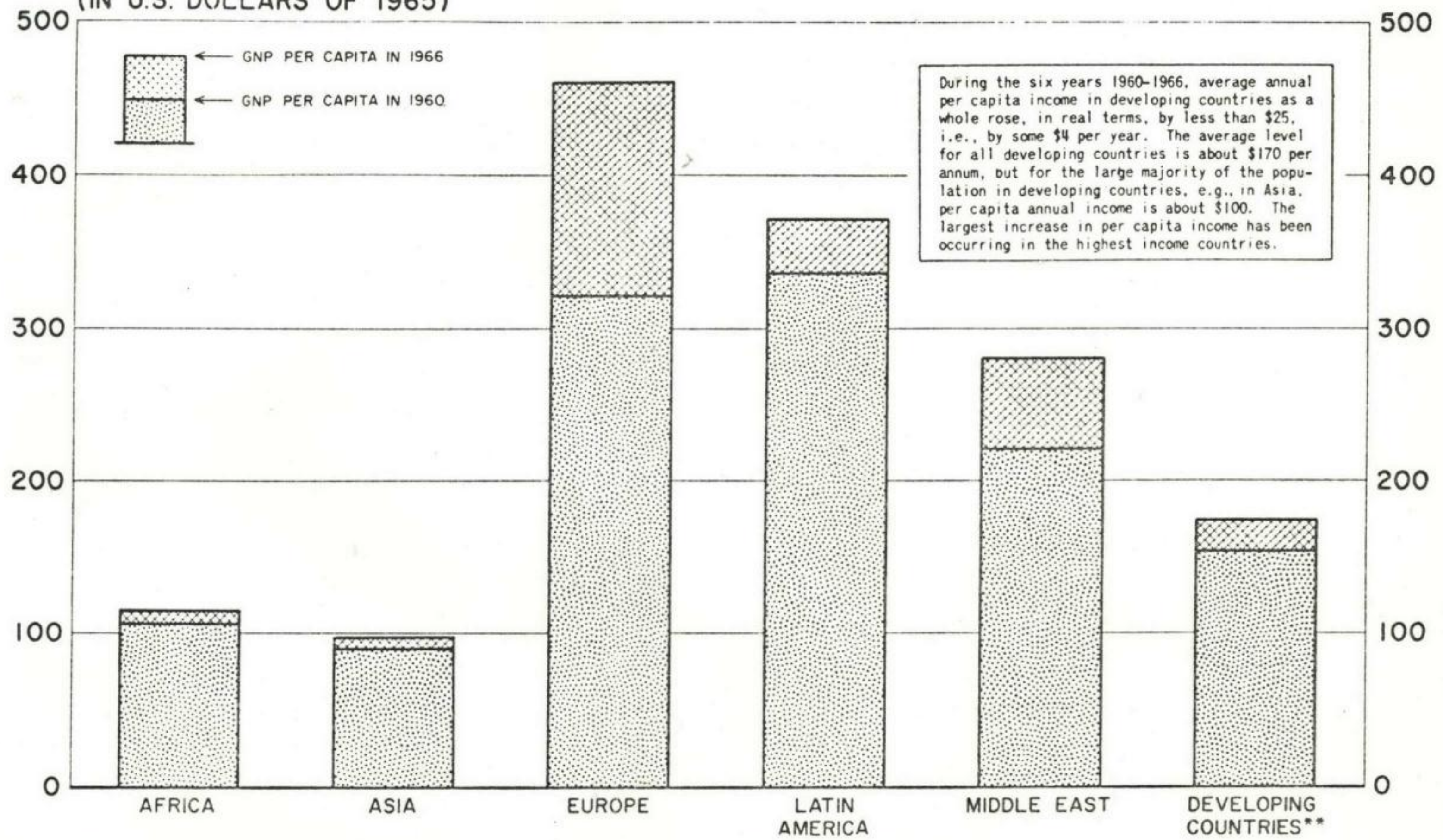


Figure 1

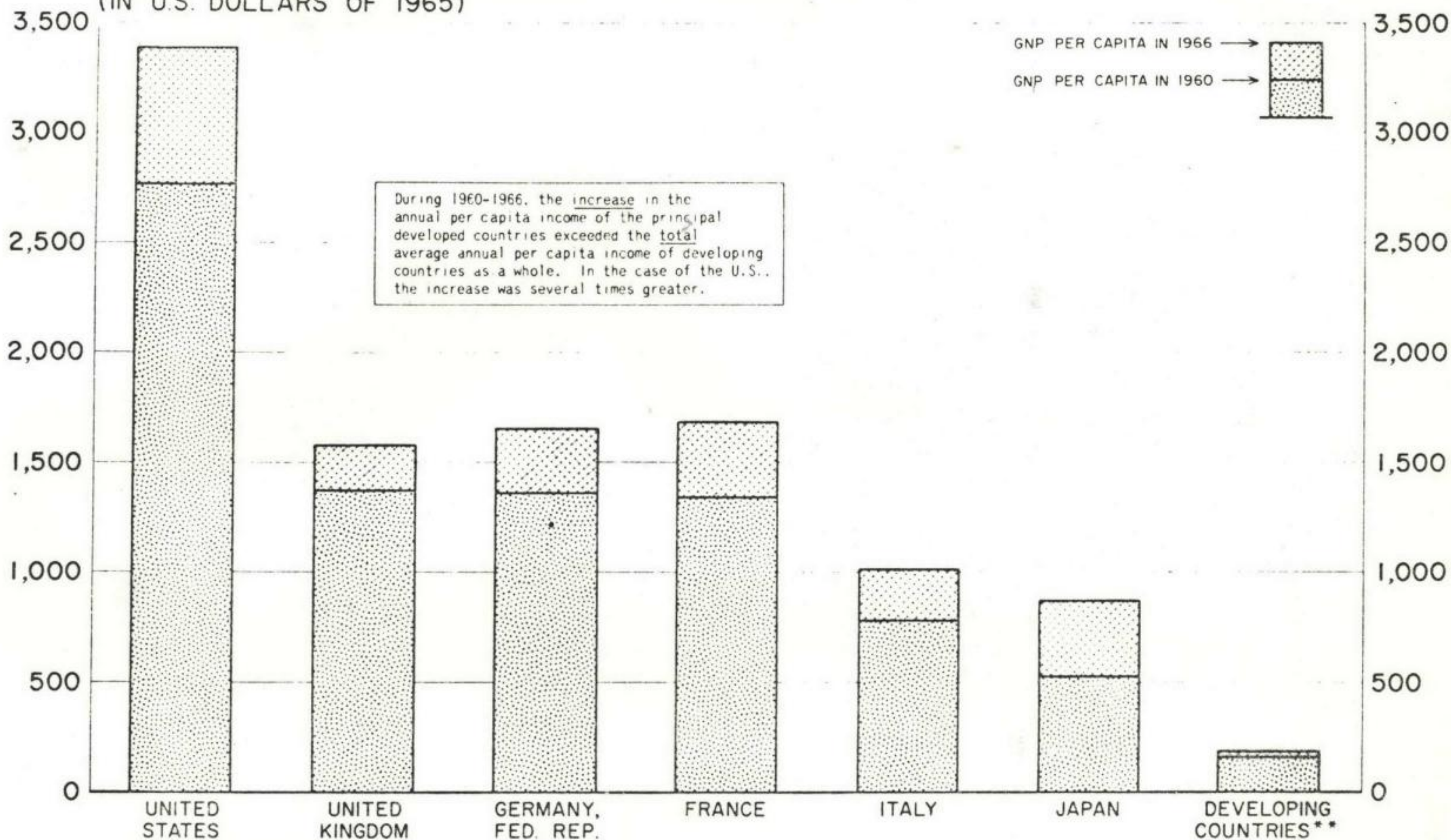


Figure 2

One thing that's obvious from our experience in economics is that a young population requires a high capital investment. I'm sure this is borne out in the experience that you've all had in your own kind of work. Therefore, when you have a rapid population growth rate in a country, you have a very high capital investment in terms of its relation to output. (We call this a high-capital-output ratio.) You need schools, you need roads, you need improvements of water supplies, you need improvements in medical facilities, you need improvements in "social capital." But, in terms of the gross national product or other consumption standards of the community, we see no reflections of these increases in social capital for years, even decades. You can point to the fact that people are healthier, but this doesn't show up in consumption standards.

Thus, what we have seen in the less-developed countries is a very small rise in the average consumption standards. More significantly, if you forecast present trends in gross national product along with present trends in population, there will be virtually no increase in the standard of living of people in the poorer countries of the world in the next 25 years. They will be living essentially the way they live now (Figure 3). Now, of course, you're going to have more highways; you are going to have more hospitals; you are going to have more of the modern technology; but in terms of the things that go into the breadbasket--into the consumption standards--you are going to see little change.

I'll now give you a very familiar statistic. It is generally expected that in the world of 2000 (Figure 4), which is within the reach of virtually everyone in this room, we expect to have about 6 billion people--our demographers tell us between 5.5 and 7.0 billion. If you take 6 billion people, we would say it's a fair guess that between 4 to 4.5 billion of this 6 billion will be living at a per capita annual income of between $100 and $200 per year in real terms as compared to the $2000 and $3000 found in the developed world. We've all had some training in statistics, and we appreciate the lack of comparability of these statistics. I'm not at all sure these figures mean that someone in the United States consumes 30 times as much as someone in India. But, it gives us some indication of what we're up against.

THE INADEQUACY OF CAPITAL

If we try to change this future, we find one of our basic problems is the inadequacy of capital in the less-developed areas. Whether you think in terms of fixed capital, the public sector versus the private sector, or human capital, I think one thing happening in economics--which has been going on for centuries, but which has become now dramatically clear--is that the capital endowment of a country has become more important than the so-called natural resource endowment of a country. Capital availability is a lot more important than what you can add up in terms of palm trees, rubber trees, or black earth.

At first it is surprising, even baffling, that countries like Indonesia or Brazil, which have resource endowments comparable to any place in the world, remain underdeveloped. For various historical reasons, the availability of capital for production and the availability of the right kinds of human beings for production are very, very scarce indeed. These are the real problems.

Now, how do we overcome these problems? The economist thinks in terms of investment: investment in fixed capital and investment in human beings. We find that 80 percent of the new investment in these poorer countries comes out of their own domestic resources. Now, this is 80

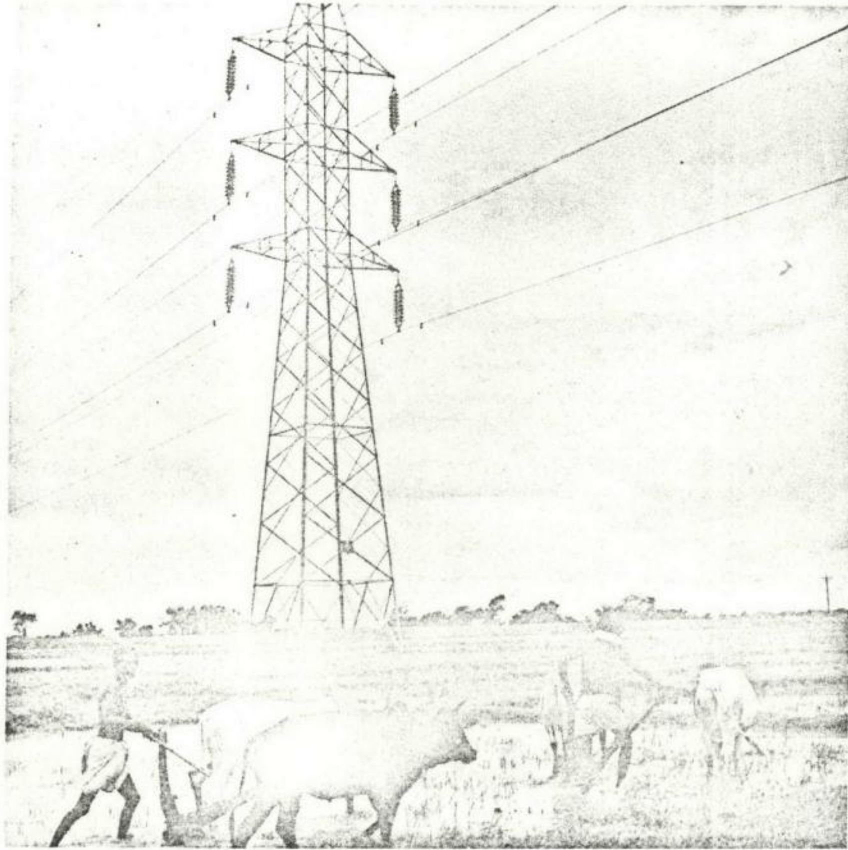


Figure 3 - India is now carrying out the third in a series of five-year plans to raise the living standards of the Indian people. The first plan, 1951-56, involved total investment in economic development, governmental and private, equivalent to $7,000 million. Investments in the second plan were over $14,000 million equivalent. The third plan, 1961-66, requires investments approximately equal to those of the first two plans put together. The WORLD BANK's lending to India now amounts to $850 million, making India the BANK's largest borrower. In addition, the International Development Association, the BANK's affiliate, has made credits to India of development finance, particularly for India's railways, for private steel production, for electric power supplies and for agriculture. The Damodar Valley is rich both in farming and industry. These Indian farmers benefit from an irrigation system provided by the Damodar Valley Corporation, which also operates the power complex for the entire Valley.

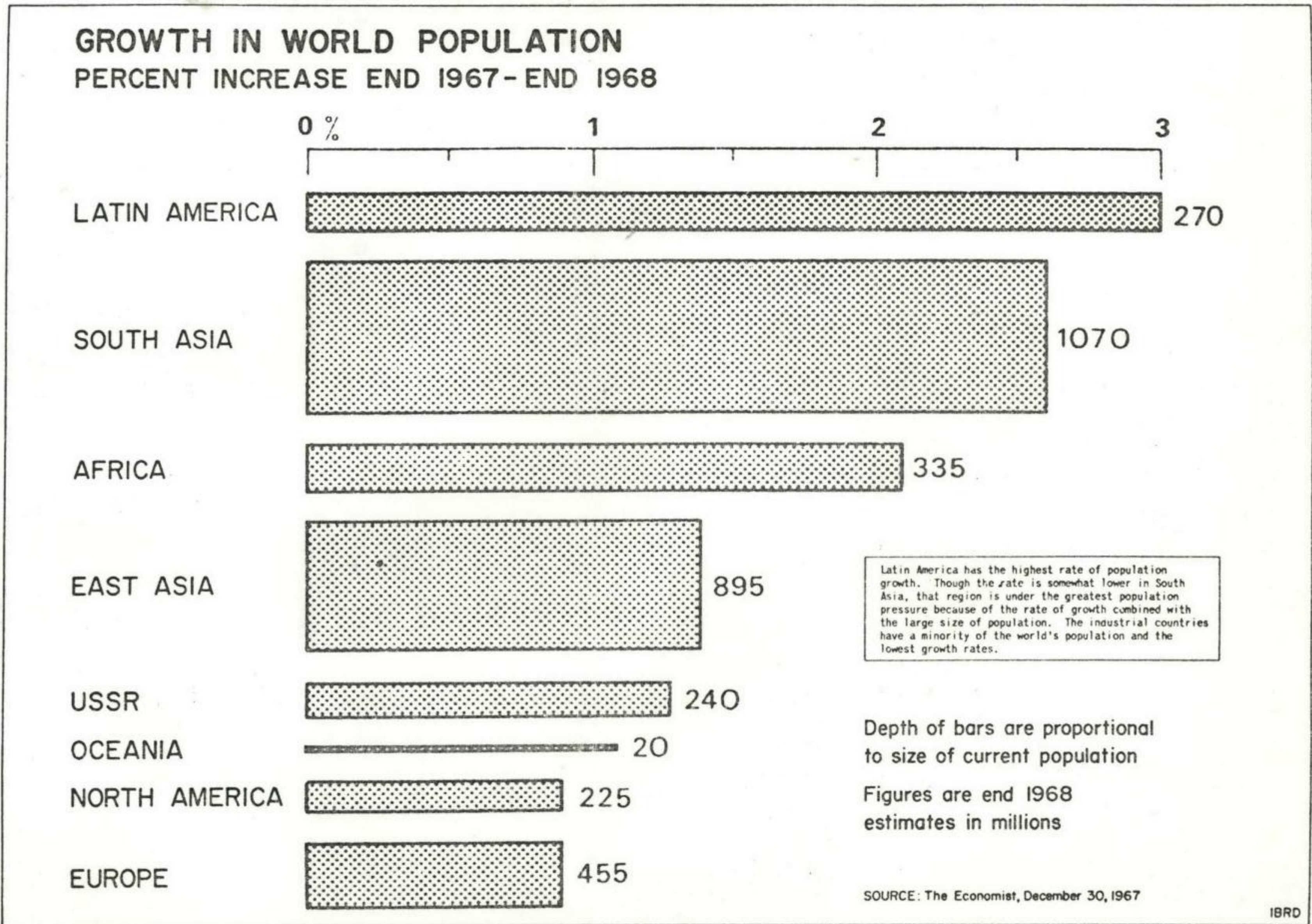


Figure 4

percent in countries where the per capita income is between $100 to $200 per year. Indeed, in Latin America we find in countries, such as Brazil, that closer to 90 and 95 percent of the investment is coming out of their own resources. This gives you some idea of what the prospects are for the future and why these forecasts are so bleak. You can see why I say standard growth or consumption-oriented forecasts are, from many points of view, unacceptable as indicators of what is actually going to occur in the future. Something is going to change the trends. As scientists we know that there are options, alternate choices, agreeable or disagreeable. Control theory helps us decide intelligently. Unfortunately, it doesn't quarantee that superior intelligence will guide decision-making. It is our task to remedy this defect.

UNEMPLOYMENT IS RAMPANT

Now, combined with these constraints on their investment effort--this dependency on adequate domestic resources--we find that there is also widespread unemployment. It would be unbelievable in the United States or any of the developed countries, but in the less-developed areas they don't talk about whether or not you can run an economy with 3.5 percent unemployment versus 5, versus 3 or even versus 2 percent in some European countries. You have overall unemployment rates of 10, 20, 25 percent of the working population in these countries. Yet, at the same time you have the paradox of a shortage of the kind of labor that is needed for breaking the many bottlenecks in the application of modern technology. Factories don't get started because there aren't enough of the right kinds of people to work in them at the same time that there is mass unemployment. Of course, as pointed out in a number of the replies to the OCTA* questionnaire, the very introduction of modern technology has aggravated the problem of unemployment. The Volta River Dam, in Ghana, made possible a large aluminum processing plant. If I remember correctly, the whole thing is run with a handful of people. When you introduce a very large capital investment, you may be actually aggravating the employment problem. You may actually have destroyed existing employment opportunities and replaced them with something that simply does not absorb the unemployed people.

INSTABILITY: ROADBLOCK TO PRIVATE INVESTMENT

Adequate external capital for the less-developed countries is simply not forthcoming. For a variety of complicated reasons, our private industry is interested in only particular kinds of activities overseas. If a country is capable of producing petroleum, it has no problem in finding foreign capital. If it is producing copper or tin, it will also probably find people interested. If a country has a stable political environment and a good geographical location, it may find private capital for tourism or even manufacturing activities. But for the less-developed world, for reasons which are inherent in the prevailing economic and social situations, private capital is scarce.

A principal reason for reluctance on the part of private capital lies in the explosive instability generated in the poorer countries by the introduction of modern technology. These countries have generation gaps not due just to age, but for the reason that people cannot communicate with one another because of the impact of modern technology, the educated and the

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* A questionnaire sent out by NASA ERC's Office of Control Theory and Application (OCTA) in 1968 soliciting comments on the status of the control field and potential future applications of control research and technology.

uneducated being two different cultures. Whole cultures are being subjected to near pulverization by modern technology. I'm not saying this is bad; I think much of it has to take place. The cultural standards of these people, in the end, have to adapt themselves to modern technology, if they are to break the vicious circles that they now live in. But because of this social and political instability, it is very understandable that a private entrepreneur, who finds investment opportunities all over the developed world, does not wish to invest money in high-risk areas. Why would he be interested in going to a country characterized by social and political instability? If he asks his economic advisors about the likelihood of the country stabilizing and if they're honest with him, they will tell him that it's probably going to get worse before it gets better. The entrepreneur has to be a man of exceptional courage and vision to see advantages in such situations.

You look next at the public capital which might respond to this situation. We find that the flow of public capital to these parts of the world is really not very large despite the publicity it gets. The net outflow of public capital from all the rich countries of the world to less-developed countries is about $7 billion a year. All of the public capital that goes to the less-developed world is shamefully small when compared to the activities of just a few of the corporations represented in this room.

GREAT EXPECTATIONS IN THE LESS–DEVELOPED NATIONS

The problem of trying to get more public capital into less-developed countries is not easy. It's not a problem of lack of morality or even--in my opinion--lack of understanding. There are very profound reasons why this public capital has not been as large as you might expect it to be, and much smaller than could be used effectively in the less-developed world at the present time. Part of the problem is that this less-developed world has come on the economic scene very, very late. They have inherited all of our modern concepts; an awareness of what life can be like. Not only do they see visible demonstrations of our way of life, through television, through the multilingual editions of *TIME Magazine* which they can look at--they can't read, but they can see the pictures; not only can they see this other kind of world, but their trade union leaders, their political leaders, and other members of their community have told them that if you're unemployed you're supposed to get paid. If you need medical care, you're supposed to be helped. If you reach old age, you're supposed to be helped. Even in an economy like that of the United States, these expectations have raised questions of feasibility. Imagine what this does in an economy where the gross national product per person is $50, $100, or $200 a year and political leaders are trying to implement welfare concepts which have developed in rich economies. Please don't take this as an indictment of welfare programs. I just point to the kinds of problems we're dealing with and their consequences.

In places like Argentina or Brazil, once a man has a job it is most difficult to get him off the job. A job is a precious thing when he's confronted with mass unemployment; and the job may have built-in pension rights, medical benefits, and unemployment insurance.

Some of you may have heard of the Argentine Railways. The deficit on their state railway system was, until recently, equivalent in monetary terms to all of the net foreign capital they obtained in any one year. The railway deficit was equal to the entire balance of payments deficit. The Government could not get rid of the excess labor supply. For years it was nearly impossible to fire anybody who had a job on the Argentine railway system, regardless of the kind of government. The railway system itself was fantastically inefficient. It was often faster to walk then to take a

train. And if you wanted to take cattle to market, you didn't take them on the train because they would simply starve. Fortunately, this particular situation is greatly improving. Until recently, however, this immobility of labor was a great problem for any economic activity. If you spoke about the industrialization of Argentina, you had a bear by the tail. How did you break this pattern? How do you change the fact that many people would just as soon not work elsewhere? Cases were reported of workers not even reporting for duty because their train was not going to leave. They got paid anyway, and life went on. In the meantime, they used their pay to open up little shops on the side to augment their incomes. How could you introduce a factory into Argentina under these conditions?

When I talked to some of their industrialists, they would say, "Look, given the problems of opening a factory in Argentina, you would do better investing in the New York stock market. You have brokers in New York and some very fine investment counsellors; they're doing all the work and you're making the money." I cite this past Argentine problem because it is a vivid example of realities in many developing countries--some more dramatic in many ways, but not unique.

One of the things we ought to recognize is that we are dealing with societies which are often not managed efficiently from an economic viewpoint. Even with all the difficulties of management in the United States and Western Europe, there is just no comparison with the lack of control in the scientific sense of the word in the less-developed countries. This is why it is so interesting to me to have modern technology consider control concepts applied to the problems of the less-developed countries.

NATIONALISM HAS RUN WILD

What are the solutions to these problems? One of the reasons I am here today is that no one has found the solutions yet. We need all the help we can get from control theory and experience in finding more effective ways of coping with these problems. Perhaps it might help if I elaborated somewhat further on the problems. Cutting across all of the instability mentioned above is a world in which nationalism has gone wild. We all believe in President Wilson's dictum of national independence and self-determination; but we have no concept of the relationships between economics and social viability, on one hand, and the desire to be a nation on the other. Nationalism is out of control.

What do you do about each tiny new country? Of course, it's easy--easy, because in terms of population they are way down there. You don't worry too much about them. You're much more concerned about the other extreme: a country like India which is not a country; it's a planet in itself (Figure 5). It's got about 500 million people with more cultures than anyone has been able to add up; with 14 official different languages and hundreds of important dialects; with a veneer of communication among a very thin layer of people who know the English language. You have what I call "planetoid economy," where it isn't a question of just a few people; you're trying to achieve social and political stability, cultural transformation, and acceptance of modern technology in nearly one-sixth of the human race. India now has a per capita income of $100 per year, and it has had no significant increase in its standard of living in the last 20 years. There are many who would claim there has been a lowering of its standard of living. What are you going to do with India when it grows to a billion people? And it's going to be just that within the foreseeable future.

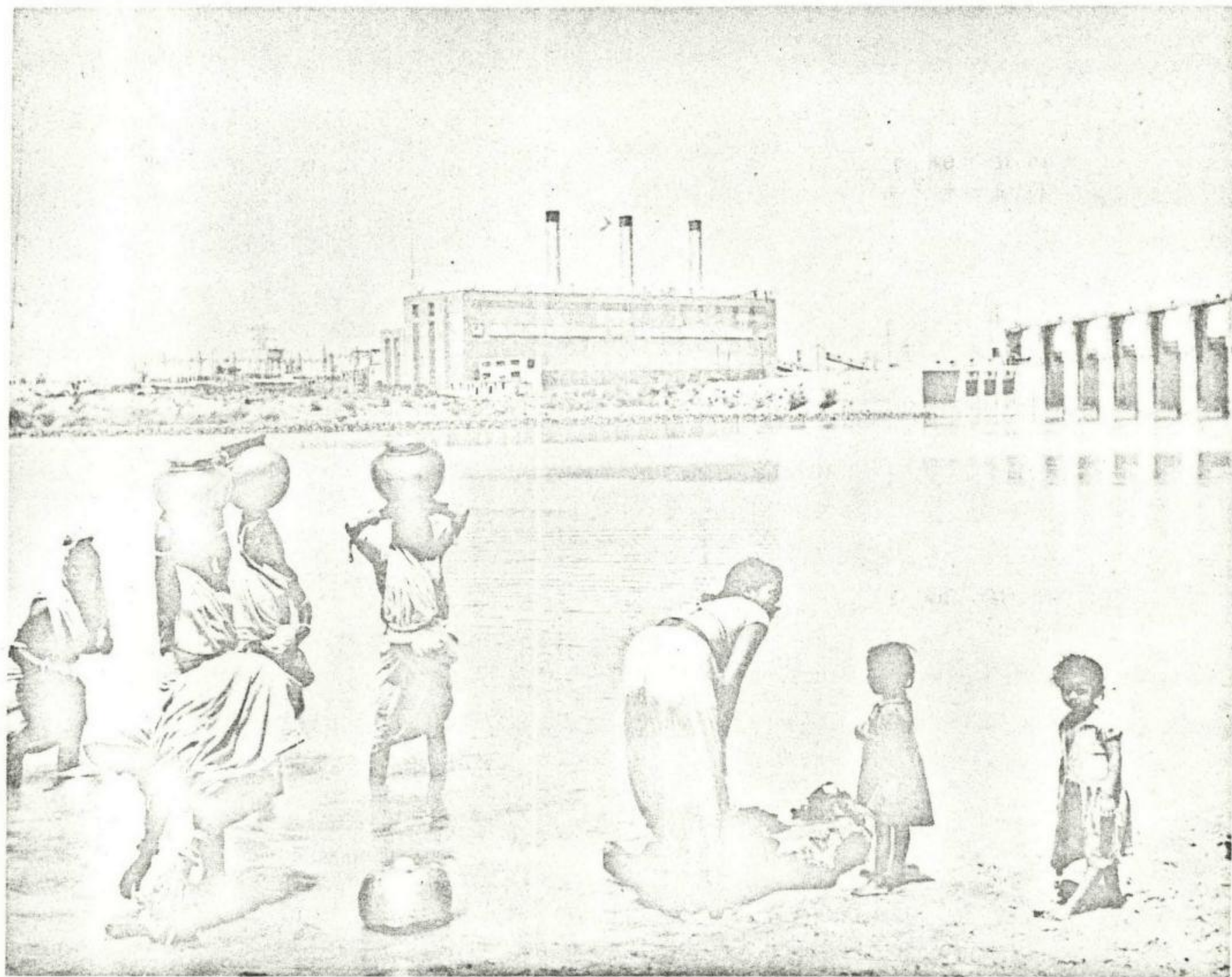

Figure 5 - Women washing clothes in the river in front of the Bokaro thermal power station in the Damodar Valley of India, which was built by the Damodar Valley Corporation with the aid of WORLD BANK funds.

We don't know about communist China. It's not one of the Bank's member countries, but I suspect that the situation there may be even more difficult than that of India because they have the additional problem of being even bigger. The biggest countries in the world are less-developed countries. We don't have a developed country that has 500 million people and no one has yet figured out how to govern effectively or efficiently 500 or 600 million people within one political unit. Yet, this is the frame of reference within which these countries have to operate. I hope this gives you some idea of some sort of introduction to the world in which the Bank operates.

HOW THE WORLD BANK OPERATES

The World Bank consists of three rather confusing organizations. There is the World Bank proper, which is the parent organization; it is essentially a banking institution. It's based on capital subscriptions by its member countries and has a total capital subscription of $22 billion. The operations of the Bank involve somewhat over $1 billion of new loans per year. We're probably going up to about $1.5 or $2.0 billion in new loans in the foreseeable future. Our lending is more or less conventional, which means it's based upon 20- and 25-year loans, which are related to the economic ability of the country to repay. It's essentially a bank in the sense that we don't make loans if we don't expect to get repaid, and we charge 6-1/2 percent interest. Our customers are among the richest firms in the world; namely, the less-developed countries or private borrowers within these countries able to obtain government guarantees.

The International Development Association, IDA, was formed because it was recognized that some countries were simply too poor or too much in debt to be able to pay back loans from the World Bank. IDA extends interest-free loans of 50 years, in which nothing is repaid for 10 years, one percent of the loan in the next 20 years, and the last of the so-called "credit" in the last 30 years. The World Bank has existed since 1946. IDA has existed only since 1960, so we haven't gotten into the period of repayment of IDA credits. Incidentally, the bulk of the funds used by the Bank consists of funds that we borrow in private capital markets. We borrow in the rich countries, and we act as a conduit to the poorer countries. This year, for example, our own borrowing operations will total well over $1 billion. Most of our borrowing this year will be in Germany. We will use these funds to make loans to the poorer countries.

Another source of Bank funds consists of the repayments on past loans made to these countries. They, of course, have to amortize their debts, and they have to make interest payments.

There is a common misconception that the United States provides the monies for the World Bank. In terms of monies actually used, considerably less than half--closer to 25 percent--of the actual monies disbursed by the World Bank find their origin in the United States, either from the private capital market or the U.S. Government.

IDA, however, receives funds from government budgets. Here, the United States provides about 40 percent of the total contributed. In addition, we in the World Bank contribute a substantial sum from our own profits. This year it is $75 million. The scale of operations of the International Development Association, in the near future, will be hopefully about $500 to $600 million a year.

We also have something called the IFC, which is an investment institution. We sometimes refer to it as our "private" arm. Its main function is to try to provide seed money and encourage private capital both in the rich less-developed countries to start new enterprises in the less-developed countries. The IFC starts new enterprises that would otherwise not get started and expansions that would otherwise not take place.

WHAT WORLD BANK TRIES TO DO

I think we could all agree that changing the trends mentioned earlier involved technological change, including new government institution building, new types of highway administrations, new types of water-control administrations, new types of city managers, and so forth. But the problems of achieving this technological change are political, social, and cultural. Perhaps this is where we begin to differ from the problems with which you gentlemen deal. We can't bring about the changes we're talking about without social, political, and cultural transformation. Thus, the problems cannot be isolated from the main cultural, political, and social streams of the country, difficult and unstable though they may be.

For the economist this is a fascinating problem, of course. It goes back to the problems that created the discipline of economics. Economics originated as a "dismal" science; and now we're again confronted by dismal problems and outlooks. We dealt with the problem of scarcity from the beginning, and now we deal with the problem of scarcities in their most acute forms. As an economist I am most interested in the kind of work that you gentlemen do--the kind of thinking you do--because perhaps your kind of thinking can help us understand better how to mobilize resources and how to allocate them more efficiently. The mistakes or suboptimal decisions imposed upon us by the cultural, social, and political situation in which we have to operate may be compensated in part if we can control our efforts better. We want to know about optimal decision-making, and at least understand what an optimal decision would be; but we know we're going to keep making suboptimal decisions. But mistakes should not arise from inadequate knowledge, inadequate theory, or inadequate models, because these things we can work on. It is possible to improve our understanding of the problems. Many of us who work in the Bank feel that the kind of work that you're doing, if applied to our problems, could make a great contribution in helping us to change the current trends we see as unacceptable to the world.

SOME AREAS FOR QUICK ACTION

What are some of the key problems with which we deal? First, how do you improve the economic and social performance of governments? How do you make countries like Brazil, Argentina, India, or Malaysia adopt better economic and social policies?

Important things, such as road building, need no spelling out here. However, what looks like a minor change in overall national economic policy may be much more important than all the investment activities of the World Bank in that country in any one year--a change in the tax structure that helps mobilize more savings and induces the use of mobilized resources for productive investment. A change in the so-called "exchange" rates for the country's currency, which determine the prices at which exports can be sold, may have much more to do with the ability of the country to earn necessary foreign exchange to buy the capital goods it needs for investment than the investment funds that you can provide from external services.

Take bigger things--take the defense programs. As we look at these less-developed countries, a number of them have a considerable fraction of their gross domestic products invested in defense establishments. The defense budgets are at times bigger than their educational budgets. Speaking to NASA, speaking to you as a U.S. group, one doesn't have to spell out how important the defense expenditures can be. But remember, in the United States you're talking about defense expenditures relative to the kind of economy we live in, the kind of productive capacity we have. But when you talk about defense expenditures in a country such as Peru or Pakistan (Figure 6), it's not only just a question of whether they have aircraft or not. Here are countries where they can't get the literacy level up above primary school, except for a small fraction of the population. Yet, they have defense budgets considerably greater than those allotted to primary school education. Why do they have these defense budgets? In some cases, of course, it's obvious why they have them; it is because they have real defense problems. In other cases you find it's because they have had admirals and generals around for a long time, and they are considered part of the culture. Thus, such countries find themselves caught in cultural patterns. You need to talk to Admiral So-and-So and ask him, by the way, what do you need all this stuff for? Wouldn't it really be better to put the money into technical education? One of the extraordinary things in Latin America is the extent that the military is often in the forefront of the field of economic development. Often it seems easier to talk to them than to many other groups. A number of them are really very forward-looking in their recognition that some of their expenditures must be cut back if their countries are to progress.

A more subtle performance factor involves taxes. The Government of the Philippines, for example, at one stage was trying to pass a small increase in taxes for four or five years. They could not get their Congress to pass the tax bill, though it was not large. Finally, it was passed but the delay was costly to the country's development. When their government puts up a tax bill, some countries will actually say to us, "Please don't give us any money until we pass a tax bill, because one of the few things we can say to legislators is that, if we don't pass a tax bill, we won't be able to finish that road."

It would be very interesting for this group to prepare a paper just on the question of performance criteria. How do you judge a country's economic performance on the national economic policy level? If you're sitting in an international organization and interested in the allocation of scarce resources and development capital, you want to do the most you can for your members. You are often driven to the point of saying, "Look, if a country doesn't do enough for itself they're not going to borrow from us; we're not going to lend our scarce resources to it." But, how do you go about judging economic performance of governments in this great variety of human experience that we face? We're looking for objective criteria because, as an international organization, we know if we say *no* to Country A, and to B we say *yes,* we ought to be able to explain why it was *no* to Country A. If we had quantifiable criteria, we'd be able to explain these decisions to countries.

We have a list of things we consider, but it is not precise and cannot be regarded as something you gentlemen would call "criteria." So we're driven back to making "seat-of-the-pants" judgments about whether performance is satisfactory or not. This is not done by intuition. We devote tremendous effort in learning as much about a country's economy as possible, in learning the constraints, in forming judgments about its various sector investment possibilities, in estimating what it can do in the field of savings, and so forth. We aren't trying to duck the responsibility of making the judgment. What we're groping for is criteria; this is why system analysis and control models are intriguing to us.

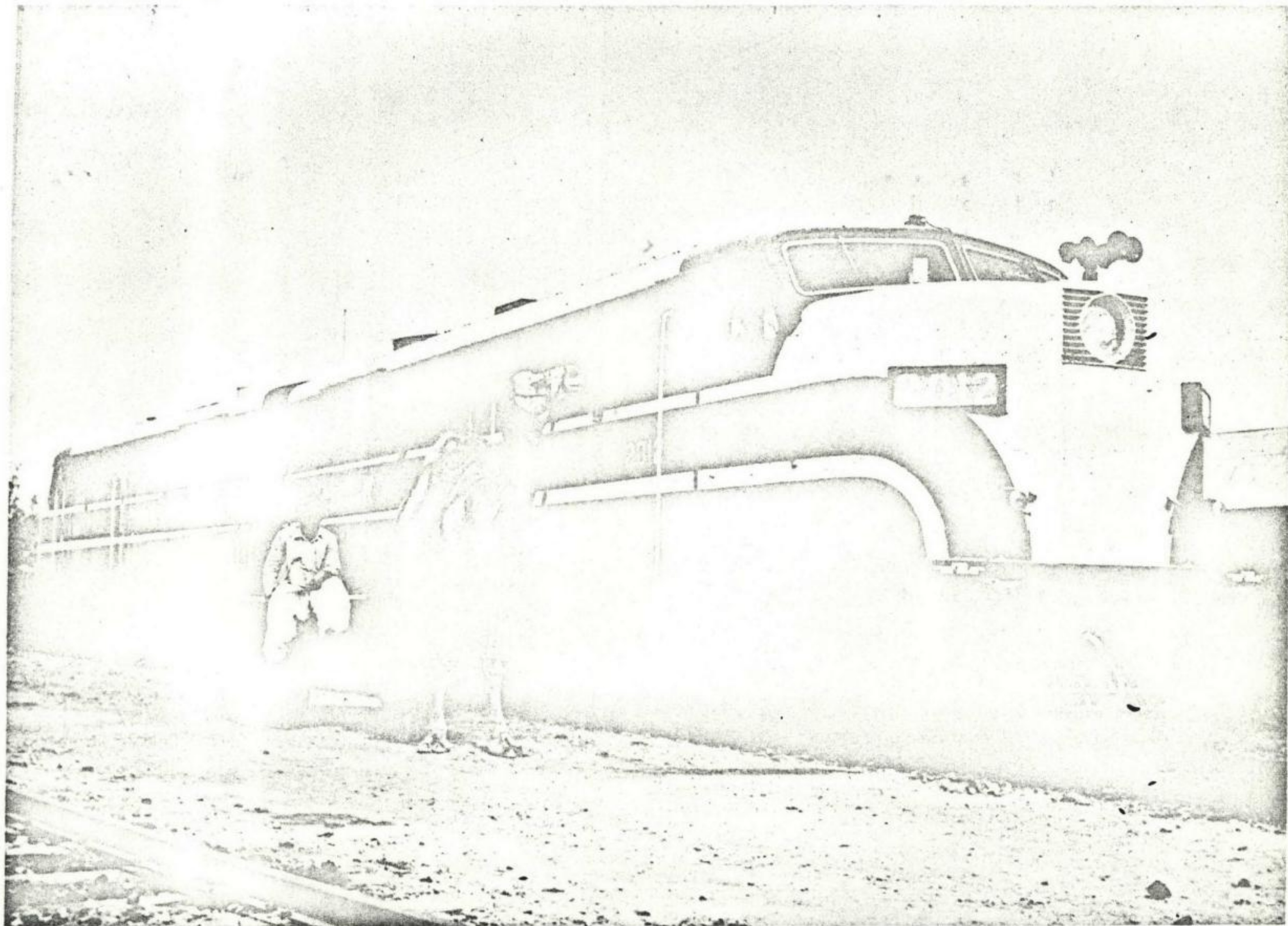

Figure 6 - The old and the new -- A camel drawn cart with his Pakistani driver stops beside a modern diesel electric locomotive in Karachi, Pakistan. This locomotive operates on the North Western Railways in Pakistan and is one of many similar locomotives purchased for Pakistan with the aid of funds from WORLD BANK loans.

A concept I think should be interesting to a group of this kind is that of *credit-worthiness.* When anybody borrows, they have to pay the loan back. When you're dealing with a government, you have a peculiar kind of constraint. A government promises to pay back, and you expect it to do so. Now, in ordinary business relations, there is the risk taken by the creditor as well as an obligation assumed by the borrower. We have a sophisticated set of laws which try to ensure the repayment. If there isn't a repayment, however, you try to protect the creditor who made the resources available in the first place, but the borrower may find all sorts of remedies if he has legitimate difficulties. But, these options do not really exist in international relations. In international relations, if a government borrows, it is expected to repay. If it defaults, its credit-worthiness plummets. Even a so-called "rescheduling," which is just a stretching out of a debt, is an act of great importance because, in terms of international financial relations, a country that has to stretch out a debt immediately becomes a dubious borrower. People are concerned about whether or not they ought to make more loans to them; and these are just those countries in desperate need of capital.

THE ECONOMIC CRYSTAL BALL

When we judge a country's ability to repay a long-term debt, we try to evaluate these countries as they're going to look--not now or the next 5 years--but 5 to 25 years from now when they're going to be repaying this debt. When you try to forecast the external economic behavior of a country between 5 and 25 years from now, some economists simply throw up their hands in horror and say this is utter nonsense; they say a forecast like this isn't worth the effort. On the other hand, some of us, including myself, feel that, if you don't try to make such forecasts, you're just really flying blind. You have to do something, even though you recognize the limitations of what you're doing.

So, one of our most intense efforts at the present time in the Bank is trying to improve forecasts of the external sector of the economy. What techniques would help us do it better, and, more challenging, if you don't like the forecast, how do you change it? You often find a situation where you look at a forecast--even one made under favorable assumptions--and you find, say, that exports are growing more rapidly than the historical trend. Nevertheless, the country will run out of its repayment capacity, although you know that its need for external capital is not going to run out. You know that it's going to need more and more capital as it develops. Therefore, somehow you have to devise a mechanism where it can borrow more money in the future despite your original forecast.

We work on this problem in two ways. First, you ask how you can change the internal economy so that the forecasts of the internal economy will change. The other way asks how you change the attitudes of the so-called "creditor" countries towards this needy country. Perhaps they can be convinced to alter their criteria, their lending terms, or perhaps they can open their markets more widely to the exports of the developing countries. However, a constraint we fully accept in the World Bank is that, if we make a loan, we surely have to be repaid because the returned monies are needed by some other poor country.

PRICE FLUCTUATIONS AND OTHER PROBLEMS

In discussing the fluctuations of export prices of the raw materials sold by these poorer countries, the question is: Can you set up a control mechanism to prevent these fluctuations from disturbing a poor country's economic development? There are all kinds of fluctuations: random fluctuations; fluctuations of a cyclical nature; long cycles related to the structure of production; and so forth.

We have also set up a separate group in the Bank to work in urbanization because we appreciate the fact that some of the most severe urban problems in the world exist in these less-developed countries. For instance, metropolitan Buenos Aires includes nearly 8 million people. You have nearly half of the population of the whole country living in one metropolitan area. Consider Rio De Janeiro, Istanbul, Calcutta, Madras, Bombay--if you'd just go and look at these cities you would understand, without knowing the statistics, what an urban problem really is. How do you solve the urban problem when you don't have the national income you have in France, Germany, the United States, or England? There is no revenue base to tackle these problems. You don't have the skilled personnel for a systematic attack on the problems of urbanization. Therefore, we're very interested in the work that's being done on urbanization in the United States. How do you do it with the least personnel, with the fewest uncertainties built into the system?

GOOD DATA ARE HARD TO FIND

We carry out our work with complete recognition of the crudity of our data. To call them "data" is often misleading. Sometimes they are not even as good as daydreaming. You just find some poor official and tell him to put down a number; so he puts down a number. We're asking them for data about subjects his people never cared about. Take population, for example. In the past, in most of the less-developed countries, the community couldn't care less if somebody were born--it was a family or tribal matter. In some cases, it has been only a police matter; that is, they'd like to know how many people live within a given civil jurisdiction. Therefore, some record may be kept. Sometimes it's a church matter. The church would like to know whether it has a growing population in a particular parish. As for people dying, that's of no interest except for the disposal of the remains in a decent manner. The vital statistics gathered at census times have no relation to those needed by someone working on family planning needs. They reflect no concept of whether population growth is a function of income, social background, employment or unemployment, or urbanization or non-urbanization. All you get out of the vital statistics is a bare number. Census statistics usually tell only how many births and deaths there were that year; sometimes in a more advanced economy, you learn whether they died from diseases or accidents. This situation exists because these cultures never intended to do anything about population; why should they go around collecting relevant data.

In sharp contrast, in the monetary field, the data are frequently superb. People have been interested in money and banking for centuries--even in these poorer countries. All countries are interested in what is happening to their short-term price movements, their external financial position, and how these things might be influenced by changes in the money supply. Thus, most less-developed countries have central banks. In fact, central banks in most less-developed countries were just set up entirely for regulating money supplies. Sometimes the banking system ends up

having the only systematic collection of trained people. They're trained only in short-term phenomena. Nevertheless they are well-trained in something practical, whereas the other agencies of government need few skilled workers. They need people to clean streets, to keep the railway passages clear; they've never developed large trained staffs.

Consequently, monetary problems constitute one of the few things we can learn about in less-developed nations. For example, we can get the statistics of what's happening to money in Brazil; but in these cases knowledge does not automatically infer adequate public policies.

We try to make up for the crudity of the data by sheer hard work. Countries get impatient with the World Bank. We probably ask more questions than anybody else. We take the longest time to make an economic report. We're never happy with the economic report. We revise it all the time. We're sending people out all the time. It's because we always feel we haven't yet reached the understanding of these economies we would like to have in order to participate in the decision-making which greatly affects these countries.

SOME CONCLUSIONS

I had planned to mention other aspects of World Bank operations, but time does not permit this. However, the kind of conclusion I come to is obvious; we must prepare for a deliberate attack on these trends I've been talking about. In that sense the future must be programmed, planned, controlled--call it what you will. We run into the same semantic problem you do. Words like "planning," "programming," and "controls" have certain connotations which, for many public policy makers, are completely misleading. When I use these words I think I use them in the same senses that scientists and engineers use them.

The free-market mechanism is as much of an instrument of control as "collaborative economics." When we use the word "control," we aren't throwing out the free-market mechanism, as many people think we are doing. We have this problem all the time. When we speak about wanting to do more work on programming or control theory, some say, "My heavens, you mean you're going to export socialism around the world." I'm sure you've had the same problem. Secondly, I think it's important for us to keep in mind all the time the importance of realistic time horizons. I think one of the fatal errors and blunders made in the field of international development and finance is the use of false time horizons. I don't know whether they are deliberately false, in the sense that people thought that it was better to advocate a false but more acceptable time horizon to a donor of funds, or whether it was a fault in theory and analysis. I don't know and don't really care about the past. What I do care about is getting across to the people a realistic time scale of when you really can expect things to happen based on what you're doing. If the time horizon is 50 years for change, or 100 years, you ought to be willing to tell people that. Time horizons should come out of economic analysis, not out of what your listener wants to hear. In our field this is particularly important because the so-called "disappointments" that you read about over and over again in the less-developed world are frequently only disappointments in time horizons. Someone will go to a legislative body and say that in 5 years a country will have self-sustaining growth. There was no more chance of that country having self-sustaining growth in 5 years than I have of living to be a million. That country couldn't have self-sustaining growth independent of net imported capital in any foreseeable future; and yet such statements were made repeatedly.

It's important that we have realistic time horizons, because those who provide the needed funds and those who give the public leadership during the difficult cultural transformations transpiring within these countries must know what they're doing. They mustn't be put in the position of making false promises because we have given them false assumptions. I know there are ranges of error, but ranges of error we can understand. They're usually completely different from the kind of time horizons tossed about loosely in our field.

Another thing I'd like to emphasize is that preference targets cannot be dictated by anybody from the outside. They have to come from the cultures of the less-developed countries themselves. There is no point in setting up a model for an economy which builds in your own preferred targets. You are wasting your time. In that sense I am critical of certain models made in this field. There's no point in making a preference target for an economy that contemplates making everybody in the country different from what he is virtually overnight. When you work out a preference target, you have to use your economic knowledge and your persuasiveness to get the country to give a higher scale of preference to those targets you consider important to the economic and social priorities of the country. In the end, that country is going to have to decide and, if it doesn't agree with you, you've engaged in a paper exercise, even if you achieved some understanding.

I'm personally very interested in this whole theory of suboptimal decision-making. Since we can't make optimal decisions, how do you go about making suboptimal decisions? I've read some of the literature, but I'm baffled. How do you go about systematically making suboptimal decisions so that you don't end up with--that word you use in technology--a "dodo?" The whole economy can become a dodo as well as a printing press. This is to me a very important question.

The last point of all is that we have to learn how to pose the new questions which basically query our premises. In national economics, particularly in the development field, we are so aggregative and we see things on such a general level that we appall anybody who deals thoughtfully on the micro-level. In investment theory or production theory, things that are regarded as variables we regard as constants. For example, take capital output ratios; you who work out production functions know you can vary labor and capital. We often use them as constants. We often use the marginal savings rate as a constant. Similarly, marginal propensities for import we may keep fixed. We know that these factors are actually variables; but when we start to build aggregative models, we find that we sweep their changing characteristics under the rug. The result, I think, is that we never ask the right questions. We ought to be asking how to change that capital output ratio. Let's start the inductive research necessary to get this knowledge. Let's find the pertinent data. If we don't get the pertinent data, let's use some incentives to get the data. Countries don't want to stay ignorant. If you point out that you have to know something, they're willing to collaborate, particularly if you're willing to help them do it--which in many cases we are. Often they're quite happy to put their unemployed or underemployed university graduates to work with you on some of this new research. But they'll never do it unless we question our own premises; unless we ask them the right questions; unless we are willing to seek new relationships.

These are the kinds of things we're doing in the Bank. I'm afraid they have been only partially stated, but I hope I have given you some idea of the sort of things we're trying to do in our institution. Thank you for listening.

FLOOR DISCUSSION

Dr. J.L. Shearer: I don't know if it's a question or a comment. I'm trying to sort out a lot of things from what you've said. It seems to me that the role of international trade in all of these efforts to help a country develop or to develop itself is a very crucial thing, and it would be perhaps the only thing that might come in this category of telling them what to do. But isn't it true that you always come back to this as a kind of common denominator, that you're always looking for ways in which they can develop some aspects of their economy for international trade, for interaction with other countries, and for the purpose of earning money to pay back loans? It's very seldom a restrictive thing of them doing something internally.

Dr. Friedman: I'm glad you made that point because the international trade aspect is critically important and one of the key problems I didn't have time to mention. Much of my time in the last year or so has been devoted to what we call our "commodity study." The governments of the world have asked us whether we can do something about this problem of the international trade with the less-developed countries. These are countries which need strong export positions to help finance imports. Yet, if you look at what constitutes their exports, you find that, in the less-developed world, 20 percent is petroleum which, of course, is very good. However, they depend mostly upon coffee, tea, rubber, tin, fats and oils, coconuts, oranges, and so forth. In order to diversify these economies, in order to give them more exports which are less vulnerable to price fluctuations, we try to strengthen their exports in addition to improving productive capacities. Of course, hopefully we try to harmonize the two.

Our problem here is that the developed world shows little interest in moving over and making room for any newcomer on the economic scene. As long as these countries want to produce coffee, the developed countries say that's great. If they want to produce more tea, fine. Of course, we won't reduce our taxes on the coffee and thereby increase coffee consumption because that's an important source of revenue. If the less-developed countries want to produce rubber, that's great. You want to produce rubber tires, fine, as long as you don't sell them to us. Of course, it just happens that the big markets of the world are in the developed countries. Of course, I am exaggerating, but the problem is there. You can't hope to develop a major export trade based upon greater sales to those other poor countries that are trying to diversify themselves. It is to the credit of some developed countries that they have recognized this problem and have made some adaptations of their trade policies with these less-developed countries. These things come too slowly.

Take another kind of export problem, you go to a country and say, "We're going to diversify your economy. What we find is that you'd be great in electronics. Why? Because you can get a few people from firms in the United States, Germany, or elsewhere, to set up an electronics parts plant so that they can have cheaper sources of supply. They can run it for you. It can be insulated from the rest of the economy. They'll produce these parts and you'll have a ready market." As an example, the industrialization of Korea is one of the brightest spots in the developing world today. Private investment has gone there, found local entrepreneurs, established plants, and has overcome this problem of market access. This is one of the reasons why we're very much in favor of private investment abroad.

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THE NEED OF DEVELOPING COUNTRIES FOR A NEW ECONOMIC PHILOSOPHY

by Irving S. Friedman

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The need of developing countries for a new economic philosophy

IRVING S. FRIEDMAN

One of the most important developments of the postwar period is the extraordinary growth of nation states. There has been at least a doubling of their numbers over the past twenty years, and the end of the process is not yet in sight. Nation building on such a scale and with such intensity is unprecedented in human history and would have produced in any age and under any given set of circumstances, however favorable, a whole range of new problems in international economic and political relationships. One has only to look at the internal history of Europe in the nineteenth century to see that the process of creating and absorbing new units into the international community of nations is difficult and painful.

In the postwar period difficulties of assimilation have been complicated by the need for the international community to adjust to a new rationale of nationhood and a new political and economic philosophy of international association. Under the prewar system sovereignty usually went hand in hand with economic and social viability and international relationships were conducted essentially on the basis of equality and self-reliance economically.

The new nation states have emerged in an environment of social and cultural divisiveness and economic backwardness; this has opened up a new dimension of international political relationships. The postwar growth of the concept of a world commitment to economic and social development of the less developed countries is connected to this phenomenon. Unilateral resource transfers to the developing world have been justified on grounds that underdevelopment as such constitutes a threat to international peace and security and should be tackled at the grass roots—better to eliminate social discontent and economic backwardness by helping to create conditions where people can have jobs, food, shelter, and hope than to embroil the world in recurring military and other crises because there are hunger and desperation and hopelessness. Coordinated international action to this end is universally accepted in principle.

After World War II the concept of the interdependence of nations largely took the form of an appeal to self-interest. For example, incomes should be sustained in the developing countries so as to provide the exporting countries with a market for manufactured goods, and the prices of raw materials should be stabilized, if possible, so as to ensure certainty of production and availability of supplies. The international community became aware that it must somehow reconcile the political concept of national sovereignty with the economic concept of interdependence—or at least coexistence—in a situation where the new nations did not define areas of cultural homogeneity and economic and social viability and where, because of the conditions in which they were formed, their mere existence created new international dangers. It set about this task in the grand manner: from the Savannah Conference in 1944, called to inaugurate the Bretton Woods ventures, the International Monetary Fund and the World Bank, to UNCTAD II in 1968 when it activated an elaborate international system to promote international peace and foster growth through unilateral resource transfer to, and concessionary trade and economic relationships with, the less developed countries.

There are three facets of this international effort to achieve social and economic transformation in the less developed countries. The first concerns the role of the developing countries themselves, the second the role of developed countries, and the third the role of international organizations.

Insofar as the first is concerned, a distinction should probably be made between environmental problems—longer term obstacles to development that must somehow be whittled down to allow for a greater responsiveness of the economy to measures for economic and social development—and problems of economic management and performance, which involve the selection of policy instruments to achieve stated objectives and the type of effort that developing countries should themselves make on a sustained basis to further their own development.

With regard to environmental problems, population growth is in many countries the most outstanding and intractable. We have re-recently read a lot about this and its relation to poverty: the Papal pronouncement on Peace and Justice dramatized the suddenly accelerated worldwide interest. The facts are indeed disquieting. Many of the developing countries will on present trends achieve a doubling

of their populations in about twenty years. Within the lifetime of our college generation, Brazil, now a country of fewer than 90 million people, will become as populous as the U.S. is today, and India may have the dubious distinction of topping the 1,000 million mark—a statistical landmark which her neighbor Communist China would already have achieved. Rapid population growth means that the countries concerned must do more and more at an ever increasing pace merely to sustain past economic gains, without much hope of adding to these gains.

What is required is not just more food—although this aspect of the problem has, rightly, in my opinion, received the greatest immediate attention—but well managed urbanization, increased physical and social infrastructure—more water, more electricity, more roads, more sanitation, more educational facilities—in short more of everything to provide a minimal degree of facilities for civilized living. The economic and social effects of this population explosion are tremendous; problems of this dimension have never been envisaged by mankind before. Many developing countries in Asia and Latin America are increasing their populations by over 3 percent. Given their very low levels of output and consequent limitation on savings required to sustain large and accelerating rates of economic growth over this period, an increase of about 1 percent to 2 percent in their per capita income per year over the next twenty years is all that can be expected even with a reasonable inflow of capital from donor countries and international organizations and good economic performance on their part. The forms and content of consumption may change under pressures of low income, urbanization, mass world-wide media of communication, the revolution in production, etc., but poverty will still be the condition of most of the world's peoples, and the contrast between conditions in the poorer countries and the richer countries is likely to be even more dramatic than today.

A second environmental problem relates to the fact that many of the new countries became independent by opting out of groupings with which they had been associated for perhaps many decades and within which their economic structures had evolved. Many of these find themselves now in a virtually unviable economic position. Wider, but looser, economic and political groups have sometimes emerged instead, but their effectiveness as organs for economic integration has varied, depending on the degree of cultural and political homogeneity

of the countries involved and the inherent scope for economic gains to all through integration. Modern day regionalism as evidenced in Central America, the West Indies, East Africa, and the areas around the Congo—to mention some conspicuous examples—can play an important role in buttressing the economics of small or poor countries to achieve the degree of economic viability consistent with their role as sovereign states.

Another major environmental problem is that of the realization of rising expectations. The twentieth century takes great pride in the fact that it is the century of "rising expectations." The phrase was coined around the turn of the century and has been used most frequently by sociologists and political scientists, usually within the context of explaining behavioral attitudes of people and their response to social change.

Rising expectations for the two billion people of the less developed world have particularly significant psychological, social, and economic effects—nationally and internationally. Although hemmed in by want and hunger and disease these people have definitions of the potentiality for material advancement of individuals and of nations, definitions which may, however, have no relationship to the realities of their own countries. Their concepts of consumption, of education, of housing, of transportation, of the employment they should have—these concepts have originated elsewhere: the United States, the Netherlands, England, France, Japan, Italy, etc. Obviously these imported concepts will not be realized for most of them in their own lifetime, or in the lifetime of their children, for that matter. Yet they hope, and they hope more and more intensely as the mass media of communications expand and their vision of the good life becomes clearer and more detailed. These hopes greatly influence private and public behavior.

This tension between expectation and reality can lead to total individual as well as national frustration. Impatience, restiveness, and hankering after the unattainable have become inevitable. Rising expectations can spur improvement but they can also have serious adverse effects on the development effort. If governments are weak and faltering, the quest for fulfillment can lead to major economic misallocation of national resources, material as well as human, as quick or glamorous gains are given priority over sustained growth or basic improvements in human well-being.

Another environmental problem is the uncertainty of economic life in some of the developing countries. A certain degree of uncertainty is desirable. In the United States we have great quarrels about taxation, monetary policy, balance of payments measures, agricultural policy, but we do not quarrel about most of the economic, political, and social system. People do not start hoarding goods in expectation that one candidate or another is going to win an election; they do not start packing their trunks or getting tickets for airplanes or liquidating their investments. To an extent something like this, however, happens in many developing countries. Where there is no assurance of continuity, there can be no real forward economic planning—private or public—no broad communal participation in national economic goals, no incentive for involvement.

The economy operating under such a system is a brittle one, liable to be cracked wide open by unexpected shocks. The less developed countries for their own sakes must somehow learn to develop a system of government in which equivocation and vagueness are replaced by a reasonable degree of certainty and preciseness. What is required is not just a legal framework for conducting economic relationships but the evolution of a public consensus as to what is right and proper, a code of personal and community behavior that is expected to prevail under changing circumstances. But these are things that must emerge from within; they cannot be transplanted, willy-nilly, from outside.

Turning from environmental problems to those of economic management and performance, the thing that strikes me as particularly characteristic of less developed countries is the diversity of economic and social objectives and the differing orders of priority given to these objectives in different countries and at different times even in the same country.

The process of development in these countries may be seen as one of simultaneous and inter-related movements along a wide spectrum of desirable objectives: faster growth in GNP, price stability, employment opportunities, income redistribution, improved social security, better education, better housing, better medical care, and so forth. Theoretically a country can choose a path of fast economic growth and ignore goals of financial viability and social integration. But for all practical purposes, this is impossible. Economic and social goals reinforce one another—especially in the longer term—and the pursuit

of one at the expense of most of the others will lead to serious economic distortions and precipitate political and social crises.

However, even if balanced economic and social development is accepted as desirable, there is no easy way of judging what blend of objectives and policies is best for a particular country; it involves not only the availability of resources but also the aspirations of people and the needs for economic, social, political, and cultural unity and cohesion. A country with a serious unemployment problem and a restive population may give high priority to employment creation and social security. Another with a strong political system and cohesive population may opt for more economic growth rather than more comprehensive social security coverage. A third with too small an entrepreneurial group may decide to concentrate its efforts on deepening the human, physical, and institutional infrastructure for development—creating more roads, generating more electricity, building more schools, establishing an agricultural bank—irrespective of the gestation period of such investment or its contribution to GNP growth in the immediate future.

Decisions regarding the choice of objectives and the means to achieve them must also take account of the relative impact of particular measures on the total developmental process—how much they can contribute to activating and sustaining a high level of economic activity, and what they can do to improve the effectiveness with which economic resources are used. Resource allocation based solely on the subjective criteria of governments without reference to opportunity costs or increasing returns or potential for future economic and social gains may lead to a brief flicker of the development flame—and no more. For the development process to be sustaining, the choice of policy measures and the means to attain them must be based on principles of economic efficiency as well as subjective needs or political requirements. This is particularly important in the international development effort. If a country requires international assistance, it may well have to prove its eligibility for help by meeting the minimal criteria of economic performance required by the international community.

In the broadest terms, "performance" covers the effectiveness with which public policy and both public and private resources and capacities are directed to the present and future promotion of economic development. It must be evaluated on the basis of detailed

knowledge of individual countries, which vary greatly in their natural and human endowments and in their institutional limitations. Because of this diversity, performance must be examined primarily on a time-series basis for each country and only secondarily on an inter-country comparative basis. A continuing examination of developments and programs of a specific country should make it possible to gauge improvement or deterioration in its performance. Each country will experience various phases in its development process, in which it may be faced with different sets of constraints and problems and in which the "blend" of appropriate policies will vary. Therefore, even in the same country the emphasis on various aspects of performance criteria may vary as different stages of development are reached.

It is customary to regard economic growth as measured in GNP, or GNP per capita, as a particularly important index of development performance; indeed as an index of economic growth it has come to be associated with development as no other single peg along the wide developmental board. This is unfortunate. Conceptual and practical difficulties of compilation and aggregation apart, an index of economic growth, which is no more than a measure of current flows and achieved increases in output, may show little of the dynamism and hidden strengths or weaknesses of an economy. This is particularly true of the developing countries where "something new" always seems to be happening. For example, drought in India in 1964 and 1965 drastically altered the short-term prospects of that country; there was a contraction in the growth index, while growth potential actually increased. Conversely, favorable weather may result in larger harvests while the growth potential of the country remains essentially unchanged. The expansion in the "absorptive capacities" of less developed nations; the establishment of more efficient organizational, institutional, and human infrastructure; improvement in techniques of monetary and fiscal management, etc., are "investments" from which returns will not be measurable for many years to come.

In short, there is a constant hum of economic activity and innovation proceeding within an economy over any time period. Thus, a simple index of economic growth cannot measure or reflect the dynamism of a society or its achievements in terms of laying the foundations for even faster economic growth in the future; it cannot evaluate the efficiency of the techniques of economic management used in

allocating or influencing the allocation of national resources; it cannot express the potential for attracting international investments or the inducements provided for encouraging exports. Even as a summary of current flows, it can only give, with varying degrees of error, an indication of the magnitude of income; it can say nothing about how this income is distributed or whether the conditions exist for a concerted national drive to development through consensus and common sacrifice. It does not tell us anything of the texture and quality of the development effort, but only that income and production increased or decreased over a particular time period.

It is for these reasons that I feel that in evaluating development performance we should look beyond growth rates and focus our attention instead on aspects of policy concerning the effectiveness of a country's own efforts, first in the mobilization of resources and next in their utilization.

Insofar as mobilization of resources is concerned, a major expression of a country's development efforts is the ratio between the rate of saving and the gross domestic product. Even more significant than the average is the marginal savings rate, which shows what part of the additional income of a nation is actually saved. Developing countries are chronically short of the savings needed for investment. Successful development usually requires that the marginal rate of savings be higher than the average rate. This question requires consideration of the extent to which tax and financial policies offer incentives to raise levels of private savings and investments. It also implies examination of the institutional aspects of the mobilization of savings, especially of a country's efforts in organizing financial institutions to mobilize additional savings and channel them into productive development.

Of special importance is the role of the public sector in raising savings rates. In most developing countries, private savings are inadequate to finance investment requirements and the public sector has to generate additional savings, often of considerable magnitude. However, it is not to be forgotten that public savings are usually involuntary savings resulting from taxation. Major indicators of the performance of the public sector are the rates of tax revenues on one hand and the levels of current expenditure on the other, both in relation to national income. Evaluation of the fiscal and budgetary systems of a country cannot be limited, however, to overall levels of revenues and expenditure; the impact of the fiscal techniques used on

economic activity and development must also be considered.

Several other factors are important in the context of policies for resource mobilization. To begin with, the government's policy towards the attraction of external private capital is important. Domestic monetary policies may also be an indication of a country's commitment to resource mobilization for development. Rapid and persistent inflation due to excessive monetary expansion will have harmful effects on the level of savings and the overall efficiency of the economy.

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, for 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 and health. Another indication is the effort to introduce satisfactory family planning. Other indicators are even 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. Needless to say, making judgments on such matters is most difficult and must be approached with care and humility.

Turning to the utilization of resources, or the economic efficiency of resource allocation, the concept of an optimal allocation of resources is still in widespread use, but I feel that for the developing countries no simple or uniform formula can be applied to determine whether or not best use is being made of available resources. In every instance the investment program must be assessed in light of the longer requirement for goods and services to spur the developmental process. Where, to take an example, investment in agricultural and other food production facilities has been lagging seriously—and this is the case for many developing countries—there is an *a priori* case for saying that an accelerated investment program for agricultural rehabilitation is needed and that more new resources should be invested in this sector than over some past time period—almost irrespective of what is happening in other sectors. At the same time a country may judge that the urgency of instituting a highly.intensive vocational training scheme or for significantly extending educational facilities is

persuasive enough for justifying a "crash" program or a series of "crash" programs over a relatively short period at the expense of, say, a new highway program.

A frequently reliable measure of effectiveness in resource utilization is success or failure in the promotion of exports, the principal source of foreign exchange for developing countries and of a far larger magnitude than external aid. The level of export earnings of a developing country, which largely determines its capacity to import, is often limited by factors beyond its own control. In many developing countries, exports are concentrated in a small number of primary products, often foodstuffs, the demand for which may be highly inelastic; thus a given increase in world supplies may well result in a much sharper fall in prices, at least in the short run. In other cases, developing countries are often faced with protected markets in the industrial countries. In addition, cyclical downturns in the industrial economies have sometimes had a harmful effect on exports of the developing countries.

In addition to these and other hazards, the expansion of exports of the developing countries is, however, strongly affected by their own price and taxation policies, as well as by the composition of investments. In a number of developing countries, prices set by central marketing boards for exportable commodities do not encourage an adequate volume of exports. In certain cases unrealistic exchange rates, sometimes combined with subsidization of domestic consumption of exportable commodities, actively inhibit the growth of exports. In some countries the tax system bears more heavily on exports than on other sources of income. The evaluation of performance in resource utilization requires an assessment of the growth rate of exports of both primary products and "non-traditional" export goods, and especially of domestic policies affecting export expansion and diversification.

Similarly, the utilization of resources is greatly influenced by government policies towards production for the domestic market and the level of protection for such production. A certain degree of protection for local industries may be favorable to economic growth, especially in the initial stages. Excessive protection of domestic industries, however, either by tariffs or by administrative restrictions on competing imports, if enduring for a long period, leads to inefficiencies which are often embodied in the structure of industries and become major

bottlenecks in the development process. The levels of tariffs and other measures of protection, therefore, serve as one of the indicators of a country's performance in the utilization of resources for the domestic market.

One question bearing on performance remains to be answered. What of situations where a country's potential development resources are being eroded by excessive military expenditures, or prestige outlays, or "white elephant" brainwaves of politicians?

It is indeed true that many of the less-developed countries have not as yet found it possible to pursue effectively sustained policies for social and economic development. Some optimists, including myself, had hoped that development would, with time, have attained the status of a sacred objective—an issue apart from other issues, about which there was sufficient public consensus to sustain its pursuance despite political, social, or economic vicissitudes. Yet in quite a number of developing countries governments past and present have not had the will or the determination to keep their countries on the path of sustained growth. Such countries are poor performers from the viewpoint of economic development.

II

I turn my attention now to the role of developed countries under the postwar international system. While these countries have repeatedly affirmed their adherence to the principle of accepting continuing responsibility for accelerating development, they have not as a group been prepared to implement fully this responsibility. They have built an elaborate institutional structure for effecting resource transfers, but have not found it possible to transfer resources on the scale required to accelerate the development process to the extent feasible. Moreover, such transfers as occur are mostly not effected in forms that will ensure a maximization of their contribution to the growth process in the less developed countries.

At the present time the combined gross national product of the developed world (excluding the Soviet bloc countries) is about $1,550 billion, the amount being saved each year about $325 billion; of this, about $7 billion is being transferred as official development assistance on a net basis. Contrasted to a near doubling over the six years, 1956-61, the volume of such development assistance virtually stagnat-

ed between the years 1961-65. Thereafter, there has been some recovery. The recent increase has been mainly due to the smaller donor countries. The net assistance from these countries increased at an annual rate of about 26 percent between 1965 and 1967. In contrast the combined net flow from major donors—France, Germany, the U.K., and the U.S.—rose by only 2.5 percent per annum. As a result, the share of the latter in the total net flow of assistance from countries belonging to the Development Assistance Committee of OECD declined from 86 percent in 1965 to 80 percent in 1967.

It is not just the inadequacy of the developed countries' contributions that is significant. Equally important is the need for continuity and certainty in the flow of development finance in any particular country over a span of years. At the present time the foreign aid programs of most donor countries are on a year-to-year basis. Hard and meritorious governmental policies, supported by the courage and sacrifice of a people, can be frustrated because a marginal amount of additional resources needed—the foreign exchange that was expected to be provided by donor countries and organizations—was just not forthcoming at the right time or in the right amount. Once embarked on the task of implementing a development program, a country simply cannot back out from mid-stream without the risk of serious misallocation and economic backsliding.

All this is the more unfortunate because the external capital resources required by the less developed countries from the developed ones have represented on average only about 20 percent of total resources that must be mobilized for implementing development programs. The developing countries can now effectively use up to $5 billion more per annum in external resources to implement their own efforts to transform themselves. Although marginal in relation to total needs, this amount is critical for sustaining and accelerating development simply because it represents foreign exchange that can finance via imports the addition to the resources available for investment made necessary by the limitations on domestic savings, usually by the importation of machinery and capital equipment and technology—normally the scarcest of all commodities in the underdeveloped countries.

I personally do not believe that the developed countries wish to opt out of their obligations to assist in the social and economic transformation of the less developed countries. What has happened, I suggest,

is that the emergence of a series of economic problems in major donor countries over the past few years—for example, the continued relative scarcity of savings in many developed countries, budgetary problems, and balance of payments deficits in the United States and the United Kingdom, coupled with a thaw in the "cold war"—have reduced somewhat the priority given by developed countries to their responsibilities in the less developed ones. This lessening of enthusiasm toward the international effort has been aided and abetted by a general atmosphere of disappointment and disillusionment about the developmental achievements of the less developed countries over the postwar decades, however unjustified in many cases.

What is required at this stage is the vigorous articulation of national interests in development finance based on realistic and hard nosed appraisals of what is happening and what can happen. Within a regime of better understanding and a fuller awareness of what really is at stake, one of the first tasks to be tackled is the authoritative estimation on a country-by-country basis of the external capital that is required over specific time periods to sustain and accelerate development in the poorer countries. We in the World Bank have made such estimates. However, whoever does it and whatever techniques are used, the objective must be to arrive at a set of figures that can serve as the linchpin for international action, a quantitative springboard from which a concerted drive to implement the international development effort can begin anew.

Having ascertained the requirements of developing countries, the developed countries must themselves agree on a "burden sharing" principle for meeting these requirements. For the so-called Development Decade (1960-1970) the United Nations had recommended that developed countries contribute 1 percent of their GNP for the economic development in the less developed countries. So far very few countries have attained this target, and present trends do not suggest that the UN recommendation will be implemented in the near future. The question needs to be considered whether the principle of a "straight across the board" commitment of this type is likely to be more politically acceptable than one based on some allocational criteria that takes into account factors such as differences in attained living standards, the degree of vulnerability of particular developed countries to international political and economic tensions, and the extent of involvement of these developed countries in the

international economy through trade and financial relationships.

The question remains of the form in which resources should be transferred. Various questions arise: Should foreign assistance be disbursed through bilateral channels or multilateral channels or some combination of both? Should it be "tied" to purchases in the donor country and particular "projects" in the less developed ones? What should be the conditions of its repayment?

Insofar as channels of disbursement are concerned, three things at least should be remembered. Bilateral programs of foreign economic assistance have developed independently of one another over the last twenty years, they serve different national purposes, and the direction of aid to recipient countries is greatly influenced by past history and current relationships. When a donor country becomes pledged to assistance above this floor, the question of multilateral versus bilateral transfers becomes operational. In such a situation the choice of channel must of course be governed by the donor's wishes, political acceptability, and other considerations. However, a particularly heavy concentration on bilateral programs can lead to an economically unbalanced aid effort, and even though the amount of resources transferred may be right, its distribution among the developing countries can be hopelessly lopsided. This will not only imply a misallocation of some development funds; it will lead to a reduction in the effectiveness of the total international program.

It seems therefore that side by side with a minimal volume of bilateral transfers, the international development effort should be oriented so as to enable the accumulation of pools of funds to be used on a multilateral basis, if only to iron out the distortions caused by the bunching of bilateral funds in particular countries or regions or for particular purposes or on particular conditions of availability. This concept of multilateral assistance as a contemporary device to achieve a more satisfactory allocation of international assistance in the less developed countries defines a minimal role for multilateralism.

There are of course other grounds for advocating expanding programs of multilateral assistance. Important among these is the argument that disbursements through international organizations *per se* can more readily satisfy economic efficiency criteria in any particular country than disbursements under bilateral programs. From the donor's viewpoint, it is also cheaper to use multilateral channels than to administer bilateral programs. Moreover, disbursements through

multilateral channels reduce the likelihood of undesired political involvements or even unwarranted criticism. Not least of the arguments for a greater share of development assistance disbursement through multilateral channels is that well organized machinery already exists for disbursing such funds on criteria that are regarded as highly satisfactory by both donor and recipient.

On the question of conditions of aid, the tying of the latter to purchases in the donor country is a common feature of most bilateral programs. This involves, in effect, a hidden subsidy by the developing countries of the exports from the developed ones; this subsidy in any particular instance is defined by the differences between the national cost of project construction under international competitive bidding and the actual cost of it through exclusive purchases from a particular donor country. Balance of payments considerations are usually regarded as the justification for aid tying, despite donor debt increases. "Donor tying" is at best a questionable condition of aid allocations. Aid disbursed through multi-lateral channels is usually granted on the principles of international competitive bidding. This fact constitutes a strong argument for expanding multilateral programs.

Turning to the question of different lending techniques, the preponderant emphasis in both bilateral and multilateral sources of international finance has been on project aid—for example, providing foreign exchange funds to a particular country to allow the expansion of the productive capacity of a given facility such as a road, power plant, or factory or of the productive capacity of an entire sector, such as agriculture or power. To what extent and in what circumstances a donor should be prepared to go beyond this and provide "program" assistance that is not tied to a particular project but is allowed to accrue instead to the development program of the government as a whole or to the entire economy is a question that still remains to be answered by most donor countries and international agencies.

In the early postwar years when most of the developing countries were just starting out on the road to development, their need for help on project preparation and design was perhaps as great as their need for external capital itself; today many of them have substantially improved their ability and their capacity to design and carry out effective development policies and programs. Over this same period changes in economic structure of some countries in degree of in-

dustrialization and in foreign trade have placed operative ceilings on their capacity to absorb effectively international assistance in the form of capital goods imported for specific projects. Most of the larger and semi-industrialized countries, such as India, Pakistan, Brazil, Mexico, and Argentina, are developing their own production of many types of machinery and equipment. Their need is not so much for more capital equipment imported from overseas to build or expand certain facilities but for a mixture of capital goods and industrial and maintenance material, much of which can perhaps be produced at home. At the same time domestic savings are not adequate for available production investment opportunities and external capital is still needed. Strict adherence to the principles of an investment project approach to international assistance can lead in such instances and others to economic inefficiencies in the use of external capital.

The question remains of what interest and repayments conditions should govern the disbursement of financial assistance for international development. A major consideration to take into account here is the phenomenal increase in indebtedness of the developing countries over the past decade. From 1956 to 1966 the medium- and long-term public debt of ninety-two developing countries increased four-fold; debt service obligations quintupled. This sharp increase in the external debt is a matter of the gravest concern for a growing number of developing countries. In some cases the burden of servicing debt has become so acute that it has required arrangements for the rescheduling of past debt, debt that must necessarily increase if their development effort is not to sputter and stall.

Unless the debt servicing capacity of the developing countries is improved one way or another, debt crises are likely to become more general in the future, especially in those countries requiring net inflows of capital for a considerable time yet. The trend is for the terms of financial assistance to developing countries to harden rather than soften: between 1961 and 1966 the share of grants in public financial assistance flows decreased from 76 percent to 63 percent; interest rates on the cumulative total of bilateral loans increased and the period of repayment shortened. The implications of this for the international development effort can be gauged from the fact that, as noted above, the flow of financial assistance remained about constant over the same period. Given onerous official debt and debt service thereon, the net flow of official funds to the developing countries was

therefore considerably reduced; yet the cumulative debt burden of this reduced flow will be higher than ever in the future. The developed countries will be sowing dragon's teeth for themselves and jeopardizing past developmental gains unless there is a program of coordinated action to lighten considerably the debt servicing burden on officially extended external finance and a willingness to reconsider the terms and conditions which should govern future development finance. It may be worth pointing out at this point that increased flows of foreign private developmental capital could greatly assist in coping with the problems of external indebtedness.

III

International organizations have three basic functions to fulfill in the international system described above. Firstly, as part of the institutional structure erected to implement the international development effort, they have a role as administrator and coordinator and, in some cases, financier. Secondly, as intergovernmental agencies with specific functional expertise, they have a role as consultant and adviser. Thirdly, as operative units of the United Nations system dedicated to the social and economic upliftment of peoples everywhere, they have a role as advocate and originator. All these roles become inextricably intertwined into one another in day-to-day functioning.

The role of administrator derives from the function of specialized agencies as the overseers of international programs for social and economic transformation. At the international level there is a whole plethora of institutions whose funcions are to assist member countries to achieve particular goals along the developmental spectrum: for instance, if a country wishes to give high priority to employment creation in its program for social and economic transformation, it can turn to the International Labor Office for technical and other assistance; if it wishes to institute a program for better health, it can turn to WHO; for better education to UNESCO; for faster economic growth to IBRD; and so on. Either by accident or design postwar international institutionalism has become structured into functional and specialized agencies, each of which acts as an international shadow of particular national objectives.

Through what media and on what principles of association do international organizations assist in helping countries to achieve

national objectives? To begin with the system as it works is one of continuous consultation in the implementation of national plans and policies. At some early stage of planning a selection of international organizations, depending on the blend of objectives to be pursued, is frequently brought into the picture primarily as advisers to fix and structure objectives and to integrate them into an international context. If country X, for instance, intends to give high priority to a crash program for employment creation during the first two years of a Development Plan, a number of international agencies, such as the International Labor Office and the World Bank, may well be brought in to do one of several things or a series of several things: for example, they may be asked to examine the objectives and the priority given to them, send missions to recommend ways and means through which they can be achieved, provide technical or financial assistance to ensure successful implementation, and supply information on what other countries in similar circumstances have done in the past or are doing at present.

An important point to remember is that in providing financial or technical assistance each individual organization uses its own allocational criteria. It may be argued that such criteria should be integrated into a total and uniform development performance test, but at the present time the type of coordination required to activate within the community of international organizations a standardized system for measuring developmental performance just does not exist. Competitiveness among international organizations may be a factor in impeding the evolution of such a code, but there are also profound uncertainties as to what criteria should be incorporated into such a code. The international organizations do not deal with simplified hypothetical cases but with complex societies whose explosive, changing characters outpace the arts and skills of man in providing satisfactory analyses, and effective government, and leadership.

The complexities of the societies and their problems coupled with the functional specialization of the international agencies may result in basic inconsistencies in advice given to member governments on developmental problems. To give one example, an organization that is concerned with unemployment problems may advise a country to use an "intermediate" labor intensive technology in the process of diversifying its economy and industrializing itself, while another,

concerned only with an economic gain, may be advocating the use of highly capital-intensive plant and machinery imported from overseas. Or one may be pressing for a fairly comprehensive social security system while another may be advising more intensified resource allocation in physical, rather than social or human, infrastructure. Such conflicts cause confusion in the minds of policy makers and serve to diminish the influence of international institutions in both developed and developing countries.

Considerations such as these demonstrate the need for the international agencies to achieve greater coordination in the advisory field. However, the difficulties of close coordination cannot be minimized; it is only partially achieved in national governments, even with long traditions of continuous government and qualified and experienced civil servants. Indeed, until much more progress is made in clarifying national objectives and in the reconciliation of national objectives with international objectives, it may well be that on balance the diversity of advice now being given serves useful purposes and helps avoid massive errors.

Coordination among international organizations could enhance the impact on development of international organizations. But there is another type of coordination that is equally important, the coordination of the activities of donor countries themselves in order to avoid major inefficiencies in bilateral aid allocations and disbursement. International organizations play an important role in such coordination; of particular importance are the World Bank, the Development Assistance Committee of the OECD, and the Inter-American Committee of the Alliance for Progress in this field.

The major donor countries need to coordinate their activities in respect to the conditions of the provision and repayment of development assistance so as to allow the developing countries to be able to service debt and yet maintain a reasonable development effort. The Development Assistance Committee (DAC) translates this general objective into specific recommendations of ways and means of accomplishing this. This is done in many ways, including analysis and criticism of bilateral aid programs of particular countries, continuous articulation of the disadvantages of aid tying, advocacy of "softer" rather than "harder" terms and conditions, increasing rather than decreasing volumes of total aid flows, and greater rather than less harmonization. The DAC has had an important salutary effect on

aid efforts, although often their successes are not clearly identifiable as such because the consequent actions are taken by others.

The World Bank, and other institutions including OECD, plays a different role in aid coordination. As the sources of aid have become more and more diversified and as the need of particular countries has increased, the World Bank especially has taken the lead in creating specific machinery whereby the case for development assistance to any one country can be put before donor countries all at once on some agreed principle or format of aid giving—some concept of development performance that can command wide acceptability among potential donors.

The formation of such consortia and consultative groups for individual countries is a recent innovation in international economic relationships; its rationale is the basic good sense not only in trying to put the program and policies of a particular aid-receiving country under the continuous scrutiny of those from whom it expects to receive aid but also in trying to match aid requirements with aid availabilities and vice versa. Aid coordination through consortium or consultative group can also serve as the instrument for negotiating the rescheduling of old debt or other debt lightening exercises in cases where it can be agreed that present debt burdens do actually frustrate the efforts of a country to develop itself. A consortium or consultative group thus provides a clearing house where the requirements and the problems of development can be aired between a developing country and the developed ones.

I turn now to an aspect of aid coordination that has its origin in regionalism. The Inter-American Committee for the Alliance for Progress is the key coordinating body for development assistance from the United States to the Latin American countries. Designed primarily to transform a bilateral aid relationship between the United States and each individual Latin American country into an intranational and multilateral relationship whose rationale is economic development of the entire Latin American region, the Committee is empowered to scrutinize development plans and policies of individual recipient countries as well as the aid and, more generally, the economic policies of the United States towards Latin America.

The work of the Inter-American Committee and the World Bank involves detailed critiques of development policies and performance as well as recommendations about terms, conditions, and volume of

aid. At the very least, together with parallel activities by the International Monetary Fund in the fields of monetary policy and balance of payments management, they demonstrate that it is possible for responsible respected inter-governmental agencies, encompassing both the developed and developing countries, to conduct effective international surveillance of national economic and financial policies on the one side and of international financial assistance on the other.

IV

After twenty years the international development effort is still in its infancy—brittle and fragile despite the great progress made. We have erected an impressive institutional structure but it remains underutilized. We have managed to create an awareness among leaders in the developed countries of the grave importance of this problem, but public opinion in most countries has not accepted the concept of development assistance as an act of national self-interest. We have tried to get developing countries to realize that development must come basically out of their own efforts and sacrifices—that their heroes must be the farmer, the factory hand, the scientist, the promoter, the banker, and the doctor—but they still see fit to place other objectives in a higher order of priority.

These countries remain particularly sensitive and wary of advice from outside, even if such advice can be proved to be demonstrably in their own interest and helps secure for them international good will and external financial resources to implement development plans. If the international development effort has sputtered, if the gains have come in drops and tricklets, it is not only because the international flow was meager or the machinery deficient or the political "climate" unfavorable but because there is not a sense of total participation to achieve objectives generally and wholeheartedly accepted by countries, both the poorer and the richer. One fact that we often tend to overlook is that what we are trying to achieve goes even beyond the social and economic transformation of nations to the far reaches of personal behavior and attitudes of people in both developed and developing countries, particularly in their attitudes towards other people.

Yet there are gains. There is much more hardheaded awareness of the problems among countries today than ever before. There are many more leaders in the developing world who have a fuller appreciation of the problems of their countries and the need for bringing

a sense of both reality and dedication to their job. There are many qualified and dedicated administrators, civil servants, and educators in these countries. Private people are accepting changes and learning how to absorb modern technology. More entrepreneurs are directing their attention and efforts to productive activities. More skilled workers are coming into being. We have come a long way compared to only ten or twenty years ago, but the transformation is only beginning. For example, in the May, 1968, riots in Paris, it was quite distressing to find that among the posters of students was one that advocated the stopping of aid to the French-speaking countries in Africa so that France could concentrate on its own internal problems. In some developing countries, expression of general concern that rapid increases in population are stultifying efforts to improve living conditions are greeted with hostile cries of outside interference. Such attitudes are not universal but they make us realize that the general understanding of the development problem is too limited for the kind of political commitments needed. We have to cultivate a much broader public understanding everywhere if we are to have any confidence that even the limited things we are doing now can have some hope of continuity in the future. And this is one thing I worry about all the time.

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AC Note of 11th July,

B.4.1: THE COURSE OF AID, TRADE AND PRIVATE INVESTMENT PLANS DURING THE 1960'S.

IRVING S. FRIEDMAN*

The available statistical information on global and regional trends in the international economic and financial relationships of the developing countries with their principal creditors and trading partners in the 1960's, generally gives a mixed picture, and tends to show that much more needs to be done to improve the position of the developing countries in international markets and in financial standing.

However, it is by no tests a picture of unmitigated deterioration or failure. There are many signs of progress, and vigorous growth points are found in many countries, but deficiencies and unsatisfacory developments are also found. For example, the trade deficits of the planning countries have increased despite the growth in their foreign trade. Prices of their exports have remained relatively stable but the terms of trade of the developing countries have deteriorated as the export prices of developed countries continued to rise throughout most of the period. Net receipts of market capital have increased markedly and there has even been an increase in total monetary reserves. But, on the other hand, service on external public debt has doubled, and total investment income which needs to be transferred abroad is estimated to have quadrupled. However, although debt outstanding, debt service and total payments of investment income greatly increased, much of this debt represents investment in infrastructure and production capacity, which will provide the basis for more rapid growth in the future. Similarly, the uninterrupted flow of direct investment has produced a cumulative total of fixed assets of sizeable proportions in the developing countries-

The 1% of GNP target still remains to be achieved in nearly all of the developed countries, but a number of countries have increased their foreign assistance programs. The overall terms of external finance have hardened as grants have declined, but the International Development Association (IDA) has been increased in size.

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Population growth continues to be a major deterrent to economic development in many developing countries, but the rate of growth of gross domestic products have been close to 5% on average, and growth in GNP per capita in the 1960's exceeded the previous decade. Data provided in the Report of the Pearson Commission Table 13, Page 376 from OECD sources indicates that in 1966 this amounted to some 30 billion, about one half of it in petroleum and other extractive industries with obvious implications for the exports of these countries. This Report has also pointed out (Table 14, page 377) that while official bilateral capital flow to the developing countries has tended to stagnate during the 1960's, flows from multilateral agencies and developing countries have gained increasing access to international capital markets.

These examples of pluses and minuses could be greatly multiplied, This mixed picture gives cause both for confidence that the problems of social and economic development are soluble, and at the same time reveal how much more needs to be done by all concerned than has been accomplished thus far.

We may more closely examine some of the significant qualitative aspects and limitations of the data.

Exports and Imports

Published global data for trade and related prices during the period show that the relative share of Sino-Soviet countries in both total imports and total exports changed little from 1960 to 1968 remaining between 11.4% to 12.1% of the total, The share of developed countries, on the other hand, increased during the period by about 3 points from 67% to 70% while that of the developing countries declined correspondingly. As pointed out above, unit value prices of imports of both developed and developing countries increased at about the same rate, but prices of developed countries' export increased much more sharply. As a result, the terms of trade of the developing countries continued to worsen, although at nowhere near the same rate as during the latter part of the previous decade. In fact, the experience of the 1960's to date may be reasonably considered as a levelling off of the rapid decline in the terms of trade of developing countries which began in 1954 after termination of the boom conditions of the Korean period.

Services and factor income data can be derived from balance of payments statistics published by the IMF, with some adjustments for coverage and geographic distribution to make them comparable with the trade and financial data derived from other sources. Several interesting

observations may be made regarding these data. First, both expenditure and earnings on services expanded more rapidly during the period than merchandise trade of the developing countries. There was, in fact, a steady increase in services as a total share of exports and imports of goods and services. The explanation for this trend must be preliminary, but the data would appear to justify the conclusion that it represents a growing diversification of the economic activity of the developing countries. Second, all of the developing areas appear to be sharing in this general trend, although there are, for one reason or another, important differences among them. For example, the debit side of the non-merchandise current account of African countries as a whole increased faster than for any other region during the 1960's. The single largest factor in this expansion was investment income, most of it presumably generated by the heavy petroleum investment which has taken place in North Africa and certain other areas. On the credit side, earnings from tourism more than doubled during the period for several regions, notably the Western Hemisphere and Southern Europe, where they constitute about one half of non-merchandise foreign income. In South Asia and the Far East, earnings on government transactions increased more than ten-fold during the period, almost doubling from 1965 to 1966 alone, primarily as a result of the conflict in Viet-Nam.

Debt And Debt Service

These data are produced by the World Bank on the basis of reports from developing member countries. They cover about 80 such countries and are estimated to cover more than 95% of the external public debt as defined under the Bank's system. Short-term debt (maturity of one year or less), private debt which is not guaranteed by the debtor governments or one of its agencies, debts repayable in local currencies, and loans from IMF are not taken to account here.

For the developing countries as a whole, debt service payments (principal and interest) doubled rising from 10.1% in 1960 to 20.7% during the period, and debt outstanding more than doubled, 21.6% in 1961 and now 47.5%. While there were increases for all regions, there were important differences among them. Thus, for example, debt outstanding increased far more rapidly in relation to debt service in Africa and Asia than in Latin America—a reflection of the relatively softer lending obtained by the first two areas and the higher volume of trade credits going to the latter. Globally, debt service ratios climbed steadily for most of the period being now 7.2%, although there was little change in the

Western Hemisphere and Europe, and a general decline in the Middle East. As inevitable with regional totals, the differing situations in individual countries tend to be disguised. In the Western Hemisphere Brazil, Argentina and Mexico had a debt service ratio in excess of 20% in 1968, that for a number of smaller countries was negligible. In Asia, India and Pakistan had relatively high ratios, while Hong Kong, which exports almost as much as India, has very little debt.

Aid and Private Capital Flows

Statistics of net official and private flows from DAC countries and of their composition are available from OECD sources. They represent net movements of assets of developed countries in the balance of payments sense i.e. they are not net of reverse movements of developing country assets, nor of investment income.

In general terms, these tables illustrate trends in development finance which are generally well known. Total receipts of external capital by the developing countries have continued to grow throughout most of the 1960's, but at a diminishing pace during the latter part of the decade until 1968. Official bilateral assistance appears to have leveled off during the past three years, while private capital flows from multilateral agencies have continued to increase, and account for most of the increases in total net receipts of developing countries, Within the total official bilateral flow, grants have declined in both absolute and relative terms from a peak in 1964-66, while net lending has increased steadily throughout most of the decade. There was little change in official bilateral capital flow from 1967 to 1968 ; the increase in total receipts of developing countries was due almost entirely to sharp increases in most categories of private flow. Direct investment continues to be the most volatile source of private capital, reflecting in large measure trends in the petroleum sector. The increase in private multilateral flows in1967 and 1968, 1.1 and 1.2 billion dollars respectively, is principally due to the increased activity of the IBRD and the IDR in major international capital markets.

The regional breakdown of official and private capital movements reveals few surprises. Total official flow to Africa has shown little tendency to increase varying between 1.59 billion dollars to 1.78 billion dollars, although lending rose steadily, 0.24 billion dollars to 0.43 billion dollars, throughout the period while bilateral grants have generally declined from the high 1.34 billion dollars to 0.95 billion dollars at present. The most striking change, which is clearly reflected in the

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debt data, has been the sixfold increase from 0.24 billion dollars to 1.44 billion dollars in official bilateral lending to Asian countries, largely India and Pakistan. Official grants to Southern Europe have declined steadily, 0.45 billion dollars to 0.04 billion dollars. The continuing importance of grants at a level of half a billion dollars in official flows to the Western Hemisphere is accounted for primarily by United States grant and local currency transactions in South America and French economic support of overseas departments in the Caribbean.

Statistics of the terms and volume indicators of net flows from DAC countries expose the failure ot the major donors to achieve their expressed policy goals of increasing official flows to developing countries at softer terms. While total flows have remained fairly constant round about 0.8% in relation to gross national product since the early 1960's, official flow has declined as a share of total flow having fallen from a high of 70.9% in 1963 to only 54.2% in 1968. As a consequence, the official flow as a share of the GNP has come down from a high of 0.64% in 1961 to as low as 0.42% of the GNP. The terms of official lending have not changed appreciably during the period. The weighted average interest varying between 3.1 to 3.8%; the weighted average maturity period of loans varying between 22.2 to 28.4 years with the similar average of the grace period being round about 5 years. Loans have increased gradually as a share of the total. As a result, the grant element of total official commitments of DAC countries which reached a high of 81.6% fell, in 1968, to 74% the lowest level of the period for which data are available. ★

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"THE ROLE OF EDUCATION IN A DEVELOPMENT STRATEGY"

By Irving S. Friedman
The Economic Adviser to the President,
International Bank for Reconstruction and Development

Address to the European Regional Conference on Educational Assistance to Developing Areas -- its Social and Economic Effects
Cologne, Germany
May 4, 1970

The progress of a nation depends first and foremost on the progress of its people. Unless it develops their spirit and human potentialities, it cannot develop much else -- materially, economically, politically or culturally.

The basic problem of much of the underdeveloped world is not so much a poverty of natural resources as the underdevelopment of their human resources. A commanding priority is to build up human capital. Or, to put it in more human terms, to renovate and update the entire process by which men and societies become modern.

One way to achieve this might seem obvious and, in principle, quite uncomplicated: Just build schools and undertake a massive program of primary, secondary education and technical training. Even this simple concept would be difficult to implement, but the problem is not conceptually that simple. These countries are not in a position to adopt any such crash program. Their limited funds for investment in education must be deployed where they will do the most good.

Each country, therefore, needs to think out carefully a realistic education strategy. This is vitally important. But it must not be an exclusively singular objective. It should be part of a broader spectrum of development that aims to move the society ahead on several key fronts.

We at the World Bank are convinced that such an overall development strategy can, if sensibly conceived and implemented, provide the essential framework for progress. And we are moving to implement this more comprehensive concept, both inside our institution and in the manner in which we provide assistance for member countries.

For instance, our new five-year country programs, initiated by Mr. McNamara, are designed not merely to increase greatly our lending volume but, more important, to instill a strong new qualitative measure into our development activities. What we are striving for is a comprehensive strategy that will constitute an overall

plan into which particular policies and individual projects can mesh as logical integral parts. Thus, educational development is not viewed in the narrow sense of simply providing a certain number of new buildings or school places but is regarded instead in the wider context of the society's population growth rate, its employment potential, the impact of different types of education in facilitating the transfer and application of modern technology and a host of other factors -- each playing on and influencing the other.

Development planners and policy makers are now more aware of the interdependencies among the economic, technological, institutional and social elements of the modernization complex. It cannot be dealt with as a series of independent parts which somehow add up. Rather, it must be treated as a kind of organic process whose elements must be kept in balance if the whole system is to function effectively.

What is the role of education in this broad scheme? I should first like to describe some general dimensions of the challenge, the Bank's general approach, with particular reference to our pre-investment analysis and sector reviews and then relate some specific examples of how the overall strategy is actually put into practice.

The World Bank Group's ultimate objective in financing education is to help stimulate economic and social development. This is our fundamental charge, stemming from the charter of the institution, and it has guided our lending since we first entered the field of education in 1962 with a credit to Tunisia for the construction of school buildings. Since then, the Bank Group has lent some $280 million for education in some 30 member countries. Our annual rate of lending, which was about $82 million in our last fiscal year, has been increasing and will increase further in the years ahead.

Although the Bank Group is a relative newcomer to educational development, we have learned rather quickly some hard lessons about the dimensions of the challenge. The main thrust of the simple expansionist strategy which rich and poor nations alike followed in past years has been to expand the existing educational establishment as rapidly as possible, with relatively little change in its structure, logistics, content and methods. The central aim -- certainly a commendable one -- has been to boost the number and percentage of young people attending educational institutions at every level. Consistent with this goal, the main measuring rods of progress have been statistics of enrollments and participation rates, and of over-all educational expenditures.

Using these measures, and viewing them against the broad sweep of history, this strategy has made dramatic gains. In less than one generation student enrollments in the world at large have more than doubled. So have educational expenditures in most countries. This is a remarkable achievement. The horizons of millions have been broadened. Children whose parents at their birth never would have dreamed of being able to offer them such opportunities are now in school with potential access to a new world. Never before have people and governments the world over demonstrated such solid faith in education as a key to individual and national advancement.

But as impressive and dramatic as these quantitative leaps are, they conceal very serious problems of quality that plague the educational systems of many

countries. The difficulties vary in form and intensity from nation to nation. Yet the basic features are similar. Essentially the problem is one of maladjustment between educational systems and their socio-economic environments. Thanks to a combination of post war revolutions -- scientific and technological, social and economic, political and demographic -- the environments of education systems have been changing at a vastly accelerated pace. This has had far-reaching implications for the size and character of educational needs and demands. And it has produced severe maladjustments, many of which were singled out in the recent Pearson Commission Report on development.

For instance, of 100 children entering primary school in the less developed countries, no more than 30 finish. Indeed, in most African and Latin American countries, more than 50% of the primary school pupils do not return to school after the second grade. Secondary schools are generally oriented toward academic study; vocational training represents less than 10% of total secondary enrollment. Moreover, only one of about 10 graduates from academic courses actually enters a university. Few of the graduates from vocational schools become active in fields for which they have been trained. At universities, most students attend courses in law or political science or in the traditional rather than newer fields of engineering and only a small fraction ever graduate. Facilities are inadequate, textbooks are lacking or antiquated, teachers are poorly trained.

We have here the makings of a cruel paradox -- qualitative deterioration in the midst of quantitative expansion, a condition in which education can easily become a cause of discontent and frustration rather than an essential source of growth and human betterment. This can impose an ominous burden on the entire social structure.

The situation, unfortunately, threatens to grow worse because of a growing economic squeeze which all educational systems face. This results from the inevitable slowdown in the growth of education's financial resources on the one hand and from an inexorable rise in its unit costs on the other. It is true that educational revenues and expenditures have risen spectacularly in recent years -- in some cases expenditures have grown at least twice as rapidly as the national economy and the overall public budget. But this surge cannot continue for simple reasons of arithmetic. In view of other pressing national needs, education just cannot go on indefinitely getting an expanding share of the national economic pie.

The other side of the economic squeeze -- rising cost per students -- stems from general inflation, of course, but even more fundamentally from the fact that education is a labor intensive industry with a relatively static handicraft technology. The teachers and the classroom are still the basic inputs. Education, however, competes for qualified manpower with less labor intensive enterprises whose technology is advancing and whose productivity and real wages are rising. Sooner or later education is forced to match the rising wage rates of these competitors, even though its productivity is not rising. This means, obviously, that real costs per student increase, even if quality remains essentially unchanged.

Within the existing educational framework, even modest improvements are costly in terms of money and manpower. In primary education, for example, expenditure has to increase nearly five times and the teacher supply by about three times in order to increase the school enrollments from 50% to 80%, to raise the ratio

of qualified teachers from about 50% to 75% and to reduce class sizes from 50 pupils to 40 during the next decade. In secondary education, similarly modest improvements would require 6 times more teachers and almost 8 times more money. It is hard to believe that additional teachers and funds of such magnitude will be available in most developing countries.

We at the Bank Group share the view of many well known educators that a new approach for the development of education is necessary and that a new strategy must be formulated to guide this approach. Education and training must be made more relevant to the needs of the particular country. Education productivity must increase. Educational planning and management must be improved. The rate of dropouts and repeaters must be reduced. The internal efficiency of the system must be increased and every effort must be explored to reduce unit costs.

Now it is easier to speak about existing shortcomings than to propose effective remedies. Basic knowledge is still very meager and the state of the analytical art in this field is still formative. Still we are invading the areas of ignorance as never before and there is significant progress. For example, the Bank's cost-benefit analysis of education in Kenya, produced last year, constitutes a real milestone, I feel, one that provides a firm foundation for intelligent education planning. The study was based on data collected in 4,742 interviews with employed Kenyans. We sought to determine private and social rates of return to investment in education, adjusted for differences in socio-economic background and other factors. We also calculated rates of return associated with different kinds of per pupil expenditures, with benefits related to improvement in examination performance. And we projected wage employment and gross domestic product alternatives for Kenya by 1974.

While the data from the study apply to the Kenya case only, the conceptual framework and analytical methods employed have wide applicability and they are under examination for adaptation elsewhere.

Beyond this thrust in basic research, the Bank is giving:

1. Greater attention to functional illiteracy for adults in those countries where the growing pool of adult illiterates constitutes a serious obstacle to development.

2. Less emphasis on physical construction and more attention to assistance in curriculum design, school administration, teacher training and long range education planning tied directly to the developmental strategy of the economy as a whole.

3. Greater commitment to educational innovation and experimentation. In collaboration with the United Nations Development Programme and Unesco, the Bank will finance a series of pilot projects designed to explore experimentally new ideas to maximize the contribution of educational systems to carefully planned economic development.

Before describing some specific examples of these new shifts in emphasis, I might say a few words about our general approach to sectoral reviewing and pre-investment analysis. Our basic aim is to be as thoroughly comprehensive as possible. Yet we must condition the exercise with a strong dose of pragmatism. It would be unrealistic to believe that the short time available for an education sector review would permit the creation of an entirely new education system. There are

undoubtedly elements which should survive in every system. As a practical matter, some developing countries exhibit very strong biases against suggestions that may seem, to an outside specialist, eminently sensible. The resistance in many instances arises essentially from an impacted mood of suspicion and distrust left over from colonial relationships. In still other cases, the resistance is more deeply engrained in the cultural heritage of the society itself.

These are not simple matters to change. Nor should we approach them with arrogance or any sense of inherent superiority. Education everywhere is in a state of acute travail and tension, with all its aspects being seriously questioned, reviewed and studied.

We must, however, try to do the best we can in not perpetuating obvious mistakes while keeping an open mind to new thinking and innovation. Searching inquiries into all parts of existing educational systems, together with evaluation of alternative structures and technologies, might be a useful and a necessary first step. This studied, deliberative and co-operative approach has a far better chance, I believe, to help provoke willingness to experiment and innovate.

The Bank tries to look at a country's education and training system in the widest sense and to evaluate the role of the system in promoting overall development. This review, we feel, should be based on the realization that each part of the system comprises a building block of a complete education pyramid. The purpose of each block is chiefly to prepare the student for a place in society rather than to prepare him for a place in the next stage of the education system. But a free and smooth flow of students within the educational system should also be possible.

An education review, we believe, should start with the existing aims and objectives of the education system and of its external productivity. Are the aims relevant to economic and social demands of the society? To the prospective overall development?

The second step in the review comprises an analysis in depth of the formal and non-formal education content and structure. How does the content meet the objectives as they are defined or should be defined? What is the correlation between the content and the demands of society and the labor market? How does the educational profile of the society compare with the school's educational profile?

Next comes an analysis of the technology of the education system. And here we use the word technology in its broadest sense to include teaching methods, management and staffing. Also in this context, a discussion of alternative technologies to improve the system is important.

The fourth step in the analysis should deal with programming and physical planning of the education system. To what extent have education and training objectives, structure, curricula, technology, population distribution, urbanization, transportation means, overall economy and financial constraints been considered in the physical planning and location of schools, or other education and training institutions? Is the utilization of staff, space and materials optimal? Have school designs been systematically studied?

The most vital phase of our analytical model is an investigation of the costs and financing of the system and its internal efficiency. Education represents both investment and consumption and in both respects it should be exposed to intra as well as to inter-sectoral priority reviews. For instance, teachers' salaries form 80 to 90% of recurrent costs. Yet in many countries, teachers' salaries are too low and the individual salaries of teachers are likely to rise markedly. At the same time, the percentage of salaries in the total educational budget frequently need to be reduced. Efforts to reduce that percentage might be discussed in this stage of analyzing costs and financing of the system. Also, the cost analysis should give cost ranges, indicate the sensitivity of such estimates to changes in inputs and, as far as possible, provide alternative costing solutions for the improvements or changes which may have been discussed previously in the review.

Finally, comes the proposal for an action program. If a sector mission has done a thorough job of analyzing the education system and the direction in which it is moving, the groundwork is then prepared to examine alternative ways of removing weaknesses and to propose realistic strategies for future development.

Obviously if such strategy is to have any real significance it must mean something more than a fine collection of pious generalities. The strategy must be selective and unified, not merely a hodge-podge of everyone's favorite education recipes. It must be sharply focused upon those major goals and critical problems which many nations have in common; it cannot attempt to embrace every special concern and interest. No educational strategy can please all, particularly not all those engaged in education. It must reject the views of some and change at least some traditional and cherished habits of thought and action.

Ideally, what should emerge is a balanced educational blueprint, one that is synchronized with broader national development goals and with specific plans and targets of related sectors. This is what modern development strategy is all about.

Now all of this is perhaps too general an overview of the Bank's approach to educational development. How have we put the principles into practice? I could cite many specific examples but because of the constraints of times, I have selected two. The first, a new project in the Ivory Coast, illustrates our attempt to make curricula more pertinent to the peculiar needs of each nation and to introduce new techniques, wherever desired, to facilitate the learning process. The second, in Colombia, exemplifies our desire to help improve educational efficiency and to help spread educational opportunity as broadly as possible.

The Ivory Coast project is unique for at least a couple of reasons. It represents the Bank's first direct assistance to primary education. And it involves the Bank's first plunge into instructional television.

The television aspect is not just a bit of novelty for novelty's sake. It is an attempt to make real impact where impact is desperately needed. The Bank is borrowing on the experience in nearby Niger, where the French government has assisted development of a successful education television system for primary school children. Anthropologists first sought clues for relevant television programming by studying the traditional ways in which tribal elders taught their young. Niger did not have a national television system, so the effort was a pioneering one in a real sense. But it is now underway and so far the progress has been most gratifying. In the 22 experimental TV classes, pupils have proven to be much more

awake and alert than in traditional classes. And the teachers have a much more relaxed and positive attitude toward the pupils.

As I have said, we are using the Niger model for guidance in our Ivory Coast project. The Ivory Coast, incidentally, has had a national television system so this should help facilitate implementation of the education project. The Bank actually is helping finance construction and equipment of the television production center, together with necessary equipment for transmission, maintenance and reception. Other public and private international agencies -- the United Nations Development Programme, Unesco, the Ford Foundation -- are assisting in other aspects of the program.

In addition to aiding establishment of the TV setup, the Bank's $11 million loan will help finance a whole range of educational improvement -- teacher training colleges, vocational and technical schools, a special fellowship program. Most of the facilities will be spread throughout the country to provide greater accessibility for more people. The new television center, for instance, will be in Bouake, the second largest city. This kind of decentralization should help take some of the pressure off of Abidjan, the capital.

Our real expectation is that this project will considerably improve primary education and teacher training throughout the country by providing (1) direct instruction for four periods of 15 minutes each per day for the first four years of primary school life and two periods thereafter (2) daily television lessons for teachers. It is proposed that, by 1980, instructional television programs will be available for the entire primary educational cycle and about 710,000 primary pupils in government schools will attend TV classes. It is also likely that, in a second phase, instructional television will be used for adult education.

Little research has been done on how to measure the economic benefits resulting from introduction of television in education. We believe, however, that with the introduction of television, a reformed curriculum, new teaching methods, improvement of the teaching force, there will be a sharp decline in the pupil dropout and repetition rates. Furthermore, pupils would be expected to reach the academic standards required for the primary school leaving certificate in five years instead of the present six. This would be a great boon for a country where now, under the prevailing curriculum and present methods, pupil dropout rates are abysmally high and the number of pupils repeating grades is just as dismal.

We have assumed that the additional capital and recurrent expenditures implied by introduction of instructional television, and of related reforms, would yield a rate of return of 35%, on the basis of the savings to be achieved on the output of primary school leavers and on the upgrading of primary school teachers over a 15 year period. This assumes, of course, that within 10 years about 710,000 pupils can be reached by television. If this were not the case, the rate of return would obviously be lower, with 14% for a minimum of 126,000 pupils reached.

The Colombian project is somewhat older, the first loan having been made two years ago. Construction of 10 large secondary school units is well under way. When finished next year, they will accommodate 48,000 students on a two shift basis.

The potential impact of the Colombian endeavor is twofold: A more pertinent type of schooling and greater educational opportunity, both from a geographic as well as a social standpoint.

Traditionally, Colombia has relied heavily on secondary education that stresses preparation for university studies. This has tended to benefit upper class groups primarily. Schools the Bank is financing will be comprehensive institutions, providing options in agricultural, commercial, industrial, social welfare and health subjects. Students will thus be better prepared for employment or further technical as well as general training.

The schools are being built throughout the country. More important, students will not be forced or "streamed" into tracks, or special channels of instruction at an early age. Experience has shown that this tracking tends to discriminate against pupils from poorer backgrounds. They often have difficulty making the transition. When this happens, performance suffers and they invariably drop out. The comprehensive school, delaying emphasis on a special track until later, is an attempt to surmount this difficulty, and to widen education opportunity.

One of the most heartening features of the Colombian project is the enthusiastic response of the people. We seem to have developed a true partnership there in educational planning and development. And one of the best signs of its success is the fact that the first school in the project -- a school in Bogota with 5,000 places -- was inaugurated more than a month ago. This is, by any standard, very rapid implementation.

Another interesting aspect of the Colombian story is that the schools in the project are deliberately designed to be used on a double shift basis. The reason is to help strike at some peculiar demographic problems and to exact the greatest possible benefit from the investment.

The demographic problems result from Colombia's rapid population growth -- 3.2% a year -- which has forced a downward shift in age distribution. In 1951, those 15 years old and under formed 39% of the population. This proportion rose to 46% in 1964. Another demographical force is the shift from rural to urban areas. Between 1951 and 1964, rural population declined from 61 to 48% of the total and this pattern is likely to continue.

Secondary school enrollment is still very low for a country in Colombia's stage of development. It is only 15% of the relevant age group, compared with 40% in Argentina, 28% in Venezuela, 22% in Brazil. Private secondary schools offer more than half of the available spaces but it is estimated that only 10% of the population can afford them since it costs about \$60 to \$85 a year in a country where per capita gross national product (GNP) averages about \$300 a year. Thus, the fortunate 10% have access to 20 times as many secondary school places per capita as the other 90%.

The Bank's project, therefore, is designed to help correct some of this imbalance of educational opportunity. But given the magnitude of the problem, it was decided to design the schools for double shift use, mornings and afternoons. To help make this possible, there will be two shifts of guidance counselors, two sets of teachers with adequate space for offices, supplies and the rest. The result is that each classroom will be used 55 periods a week instead of 35. On an economic basis over-all benefits will be enhanced in relation to costs. But more important, 48,000 young people will have an opportunity that never existed before to get some schooling.

I should point out that in addition to lending for specific education projects, the Bank also provides technical assistance. One of our missions, for example, undertook a detailed analysis in 1967 of certain aspects of the University of East Africa and its development plan. Although there were no construction loans or credits involved, the analysis did expand the fund of knowledge about limitations imposed by resource constraints. And it suggested qualitative changes that would maximize the productivity of the educational system. For instance, it was suggested that certain physical facilities could be better utilized, that the student-teacher ratio in some faculties could be increased, that teaching loads of certain professional staff were too low, that there was a risk that the university system was expanding faster than the supply of secondary school graduates. This analysis served as a background document for a donor conference later in 1967 to discuss additional aid to higher education in East Africa. These procedures, we feel, have contributed greatly to the emergence of a far more realistic framework for intelligent deliberation and policy making.

I certainly do not mean to imply with this discussion that the Bank, in its development strategy and project lending, has found the path to some educational El Dorado. It hasn't. Education constitutes just one, albeit very important, segment of the broad scenario of modernization. And there are no quick, easy realistic answers in this field. The Bank's role in the total scheme of things is relatively minor. But we intend to make a greater contribution. And we hope that our real impact can be measured not so much in dollar volume or numbers of projects but in catalytic force, by searching out innovations, in probing for new methods that, once proven, can help inspire people to undertake their own reforms.

We cannot say that an investment of _x_ dollars in education will produce a _y_ result in social and economic development or growth. All we can predict is that a well educated and motivated people have a better chance to do well. History has repeatedly shown that education does contain seeds that can inspire and energize a whole people.

Perhaps the main potential advantage of development to the individual is that it increases his degrees of freedom. By conferring upon him a healthy and well nourished body, and an educated mind, it gives him a freedom not possessed by men half-starved, illiterate and chronically sick.

Freedom for what? Essentially the only freedom worth anything to an individual is to select those activities through which his latent capacities achieve fullest development. The Greek ideal of a sound mind combined with a sound body still has validity. And though it still is only a distant ideal for the majority of people in the poorer countries, it remains a reliable star by which struggling mankind can set its course.

This, then, is what I perceive to be the essential role of education in development. To help extend the freedom of the individual. This is the challenge. And the hope.

Thank you.

Address to the

European Regional Conference

on

Educational Assistance to Developing Areas -- its Social and Economic Effects

"The Role of Education in a Development Strategy"

by

Irving S. Friedman
The Economic Adviser to the President

Cologne, Germany
May 4, 1970

"The Role of Education in a Development Strategy"

The progress of a nation depends first and foremost on the progress of its people. Unless it develops their spirit and human potentialities, it cannot develop much else -- materially, economically, politically or culturally.

The basic problem of much of the underdeveloped world is not so much a poverty of natural resources as the underdevelopment of their human resources. A commanding priority, is to build up human capital. Or to put it in more human terms, to renovate and update the entire process by which men and societies become modern.

One way to achieve this might seem obvious and, in principle, quite uncomplicated: Just build schools and undertake a massive program of primary, secondary education and technical training. Even this simple concept would be difficult to implement, but the problem, as you are well aware, is not conceptually that simple. These countries are not in a position to adopt any such crash program. Their limited funds for investment in education must be deployed where they will do the most good and many useful and constructive activities will simply not be done because of a lack of resources.

Moreover, the shotgun approach may create more difficulties than it solves.

Each country, therefore, needs to think out carefully a realistic education strategy. This is vitally important. But it must not be an exclusively singular objective. It should be part of a broader spectrum of development that aims to move the society ahead on several key fronts.

We at the World Bank are convinced that such an overall development strategy can, if sensibly conceived and implemented, provide the essential framework for progress. And we are moving to implement this more comprehensive concept, both inside our institution and in the manner we provide assistance for member countries.

For instance, our new five-year country programs initiated by Mr. McNamara, are designed not merely to increase greatly our lending volume but, more important, to instill a strong new qualitative measure into our development activities. What we are striving for is a comprehensive strategy that will constitute an overall plan into which particular policies and individual projects can mesh as logical integral parts. Thus, educational development is not viewed in the narrow sense of simply providing a certain number of new buildings or school places but is regarded instead in the

wider context of the society's population growth rate, its employment potential, the impact of different types of education in facilitating the transfer and application of modern technology and a host of other factors -- each playing on and influencing the other.

Development planners and policy makers are now more aware of the interdependencies and pervasive interconnections among the economic, technological, institutional and social elements of the modernization complex. It cannot be dealt with as a series of independent parts which somehow add up. Rather, it must be treated as a kind of organic process whose elements must be kept in balance if the whole system is to function effectively. Development, in short, is like a Gobelin tapestry, precious, because of the greatest care taken with the smallest detail to achieve a vision of something beautiful and unified. And while development can take many forms, isolated attention to one or two of its dimensions is unlikely either to be efficient or productive.

What is the role of education in this broad scheme? I should first like to describe some general dimensions of the challenge, the Bank's general approach, with particular reference to our pre-investment analysis

and sector reviews and then relate some specific examples of how the overall strategy is actually put into practice.

The World Bank Group's ultimate objective in financing education is to help stimulate economic and social development. This is our fundamental charge, stemming from the charter of the institution, and it has guided our lending since we first entered the field of education in 1962 with a credit to Tunisia for the construction of school buildings. Since then, the Bank Group has lent some $280 million in some 30 member countries. Our annual rate of lending, which was about $82 million in our last fiscal year, has been increasing and will increase further in the years ahead.

Although the Bank Group is a relative newcomer to educational development, we have learned rather quickly some hard lessons about the dimensions of the challenge. The main thrust of the simple expansionist strategy which rich and poor nations alike followed in past years has been to expand the existing educational establishment as rapidly as possible, with relatively little change in its structure, logistics, content and methods. The central aim -- certainly a commendable one -- has been to boost the number and percentage of young people attending educational institutions at every level. Consistent with this goal, the main measuring rods of progress have been the statistics of enrollments and participation rates, and of over-all educational expenditures.

Using these measures, and viewing them against the broad sweep of history, this strategy has made dramatic gains. In less than one generation student enrollments in the world at large have more than doubled. So have educational expenditures in most countries. This is a remarkable achievement. The horizons of millions have been broadened. Children whose parents at their birth never would have dreamed of being able to offer them such opportunities, are now in school with potential access to a new world.

Never before have people and governments the world over demonstrated such solid faith in education as a key to individual and national advancement. And never before have the human resources and productive potential of nations been so broadly enriched through education.

But as impressive and dramatic as these quantitative leaps are, they conceal very serious problems of quality that plague the educational systems of many countries. The difficulties vary in form and intensity from nation to nation, according to differences in local circumstances. Yet the basic features are similar. Essentially the problem is one of maladjustment between educational systems and their socio-economic environments. Thanks to a combination of post war revolutions -- scientific and technological, social and economic, political and demograhic -- the environments of education systems have been changing at a vastly accelerated pace. This has had far reaching implications for the size and character of educational needs and demands. And it has produced severe maladjustments, many of which were singled out in the recent Pearson Commission Report on development.

For instance, of 100 children entering primary school in the less developed countries, no more than 30 finish. Indeed, in most African and

Latin American countries, more than 50% of the primary school pupils do not return to school after the second grade. Secondary schools are generally oriented toward academic study and vocational training represents less than 10% of total secondary enrollment. Moreover, only one of about 10 graduates from academic courses actually enters a university. Few of the graduates from vocational schools become active in fields for which they have been trained. At universities, most students attend courses in law or political science or in the traditional rather than newer fields of engineering and only a small fraction ever graduate. Facilities are inadequate, textbooks are lacking or antiquated, teachers are poorly trained.

We have here the makings of a cruel paradox -- qualitative deterioration in the midst of quantative expansion, a condition in which education can easily become a cause of discontent and frustration rathar than an essential source of growth and human betterment. This can impose an ominous burden on the entire social structure.

The situation, unfortunately, threatens to grow worse because of a growing economic squeeze which all educational systems face. This results from the inevitable slowdown in the growth of education's financial resources on the one hand and from an inexorable rise in its unit costs on the other.

It is true that educational revenues and expenditures have risen spectacularly in recent years -- in some cases expenditures have grown at least twice as rapidly as the national economy and the overall public budget. But this surge cannot continue, for simple reasons of arithmetic. In view of other pressing national needs education just cannot go on indefinitely getting an expanding share of the national economic pie.

The other size side of the economic squeeze -- rising cost per students -- stems from general inflation, of course, but even more fundamentally from the fact that education is a labor intensive industry with a relatively static handicraft techonology. The teachers and the classroom are still the basic inputs. Education, however, competes for highly qualified manpower with less labor intensive enterprises whose technology is advancing and whose productivity and real wages are rising. Sooner or later education is forced to match the rising wage rates of these competitors, even though its productivity is not rising. This means, obviously, that real costs per student increase, even if quality remains essentially unchanged.

Within the existing educational framework, even modest improvements are costly in terms of money and manpower. In primary education, for example, expenditure has to be increased nearly five times and the teacher

supply by about three times in order to increase the school enrollments from 50% to 80%, to raise the ratio of qualified teachers from about 50% to 75% and to reduce class sizes from 50 pupils to 40 during the next decade. In secondary education, similarly modest improvements would require 6 times more teachers and almost 8 times more money. It is hard to believe that additional teachers and funds of such magnitude will be available in most developing countries.

We at the Bank Group share the view of many well known educators that a new approach for the development of education is necessary and that a new strategy must be formulated to guide this approach. Education and training must be made more relevant to the needs of the particular country. Education productivity must increase. Educational planning and management must be improved. The rate of dropouts and repeaters must be reduced. The internal efficiency of the system must be increased and every effort must be explored to reduce unit costs.

Now it is easier to speak about existing shortcomings than to propose effective remedies. Basic knowledge is still very meager and the state of the analytical art in this field is still formative. Still we are invading

the areas of ignorance as never before and there is significant progress. For example, the Bank's cost-benefit analysis of education in Kenya, produced last year, constitutes a real milestone, I feel, one that provides a firm foundation for intelligent education planning. The study was based on data collected in 4,742 interviews with employed Kenyans. We sought to determine private and social rates of return to investment in education, adjusted for differences in socio-economic background and other factors. We also calculated rates of return associated with different kinds of per pupil expenditures, with benefits related to improvement in examination performance. And we projected wage employment and gross domestic product alternatives for Kenya by 1974.

While the data from the study apply to the Kenya case only, the conceptual framework and analytical methods employed have wide applicability and they are under examination for adaptation elsewhere.

Beyond this thrust in basic research, the Bank is giving:

1. Greater attention to functional illiteracy for adults in those countries where the growing pool of adult illiterates constitutes a serious obstacle to development.

2. Less emphasis on physical construction and more attention to

assistance in curriculum design, school administration, teacher training and long range education plannning tied directly to the developmental strategy of the economy as a whole.

3. Greater commitment to educational innovation and experimentation. In collaboration with the United Nations Development programme and Unesco, the Bank will finance a series of pilot projects designed to explore experimentally new ideas to maximize the contribution of educational systems to carefully planned economic development.

Before describing some specific examples of these new shifts in emphasis, I might say a few words about our general approach to sectoral reviewing and pre-investment analysis. Our basic aim is to be as thoroughly comprehensive as possible. Yet we must condition the exercise with a strong dose of pragmatism. It would be unrealistic to believe that the short time available for an education sector review would permit the creation of an entirely new education system. There are undoubtedly elements which should survive in every system. As a practical matter, some developing countries exhibit very strong biases against suggestions that may seem, to an outside

specialist, eminently sensible. The resistance in many instances arises essentially from an impacted mood of suspicion and distrust left over from colonial relationships. In still other cases, the resistance is more deeply engrained in the cultural heritage of the society itself.

These are not simple matters to change. Nor should we approach them with arrogance or any sense of inherent superiority. Education everywhere is in a state of acute travail and tension, with all its aspects being seriously questioned, reviewed and studied.

We must, however, try to do the best we can in not perpetuating obvious mistakes while keeping an open mind to new thinking and innovation. Searching inquiries into all parts of existing educational systems, together with evaluation of alternative structures and technologies, might be a useful and a necessary first step. This studied, deliberative and co-operative approach has a far better chance, I believe, to help provoke willingness to experiment and innovate.

The Bank tries to look at a country's education and training system in the widest sense and to evaluate the role of the system in promoting

overall development. This review, we feel, should be based on the realization that each part of the system comprises a building block of a complete education pyramid. The purpose of each block is chiefly to prepare the student for a place in society rather than to prepare him for a place in the next stage of the education system. But a free and smooth flow of students within the educational system should also be possible.

An education review, we believe, should start with the existing aims and objectives of the education system and of its external productivity. Are the aims relevant to economic and social demands of the society? To the prospective overall development?

The second step in the review comprises an analysis in depth of the formal and non-formal education content and structure. How does the content meet the objectives as they are defined or should be defined? What is the correlation between the content and the demands of society and the labor market? How does the educational profile of the society compare with the school's educational profile?

Next comes an analysis of the technology of the education system. And here we use the word technology in its broadest sense to include

teaching methods, management and staffing. Also in this context, a discussion of alternative technologies to improve the system is important.

The fourth step in the analysis should deal with programming and physical planning of the education system. To what extent have education and training objectives, structure, curricula, technology, population distribution, urbanization, transportation means, overall economy and financial constraints been considered in the physical planning and location of schools, or other education and training institutions? Is the utilization of staff, space and materials optimal? Have school designs been systematically studied?

The most vital phase of our analytical model is an investigation of the costs and financing of the system and its internal efficiency. Education represents both investment and consumption and in both respects it should be exposed to _intra_ as well as to _inter_-sectoral priority reviews. For instance, teachers' salaries form 80 to 90% of recurrent costs. Yet in many countries, teachers' salaries are too low and the individual salaries of teachers are likely to rise markedly. At the same time, the percentage of salaries in the total educational budget frequently

need to be reduced. Efforts to reduce that percentage might be discussed in this stage of analyzing costs and financing of the system. Also, the cost analysis should give cost ranges, indicate the sensitivity of such estimates to changes in inputs and, as far as possible, provide alternative costing solutions for the improvements or changes which may have been discussed previously in the review.

Finally, comes the proposal for an action program. If a sector mission has done a thorough job of analyzing the education system and the direction in which it is moving, the groundwork is then prepared to examine alternative ways of removing weaknesses and to propose realistic strategies for future development.

Obviously if such strategy is to have any real significance it must mean something more than a fine collection of pious generalities. The strategy must be selective and unified, not merely a hodge-podge of everyone's favorite education recipes. It must be sharply focused upon those major goals and critical problems which many nations have in common; it cannot attempt to embrace every special concern and interest. No educational strategy can please all, particularly not all those engaged in education.

It must reject the views of some and change at least some traditional and cherished habits of thought and action.

Ideally, what should emerge is a balanced educational blueprint, one that is synchronized with broader national development goals and with specific plans and targets of related sectors. This is what modern development strategy is all about.

Now all of this is perhaps too general an overview of the Bank's approach to educational development. How have we put the principles into practice? I could cite many specific examples but because of the constraints of times, I have selected two. The first, a new project in the Ivory Coast, illustrates our attempt to make curricula more pertinent to the peculiar needs of each nation and to introduce new techniques, wherever desired, to facilitate the learning process. The second, in Colombia, exemplifies our desire to help improve educational efficiency and to help spread educational opportunity as broadly as possible.

The Ivory Coast project is unique for at least a couple of reasons. It represents the Bank's first direct assistance to primary education. And it involves the Bank's first plunge into instructional television.

The television aspect is not just a bit of novelty for novelty's sake. It is an attempt to make real impact where impact is desperately needed. The Bank is borrowing on the experience in nearby Niger, where the French government has assisted development of a successful education television system for primary school children. Anthropologists first sought clues for relevant television programming by studying the traditional ways in which tribal elders taught their young. Niger did not have a national television system, so the effort was a pioneering one in a real sense. But it is now underway and so far the progress has been most gratifying. In the 22 experimental TV classes, pupils have proven to be much more awake and alert than in traditional classes. And the teachers have a much more relaxed and positive attitude toward the pupils.

As I have said, we are using the Niger model for guidance in our Ivory Coast project. The Ivory Coast, incidentally, has had a national television system so this should help facilitate implementation of the education project. The Bank actually is helping finance construction and equipment of the television production center, together with necessary equipment for transmission maintenance and reception. Other/public and private international

agencies -- the United Nations Development Programme, Unesco, the Ford Foundation -- are assisting in other aspects of the program.

In addition to aiding establishment of the TV setup, the Bank's $11 million loan will help finance a whole range of educational improvement -- teacher training colleges, vocational and technical schools, a special fellowship program. Most of the facilities will be spread throughout the country to provide greater accessibility for more people. The new television center, for instance, will be in Bouake, the second largest city. This kind of decentralization should help take some of the pressure off of Abidjan, the capital.

Our real expectation is that this project will considerably improve primary education and teacher training throughout the country by providing (1) direct instruction for four periods of 15 minutes each per day for the first four years of primary school life and two periods thereafter (2) daily television lessons for teachers. It is proposed that, by 1980, instructional television programs will be available for the entire primary educational cycle and about 710,000 primary pupils in government schools will attend TV classes. It is also likely that, in a second phase,

instructional television will be used for adult education.

Little research has been done on how to measure the economic benefits resulting from introduction of television in education. We believe, however, that with the introduction of television, a reformed curriculum, new teaching methods, improvement of the teaching force, there will be a sharp decline in the pupil dropout and repetition rates. Furthermore, pupils would be expected to reach the academic standards required for the primary school leaving certificate in five years instead of the present six. This would be a great boon for a country where now, under the prevailing curriculum and present methods, pupil dropout rates are abysmally high and the number of pupils repeating grades is just as dismal.

We have assumed that the additional capital and recurrent expenditures implied by introduction of instructional television, and of related reforms, would yield a rate of return of 35%, on the basis of the savings to be achieved on the output of primary school leavers and on the upgrading of primary school teachers over a 15 year period. This assumes, of course, that within 10 years about 710,000 pupils can be reached by television. If this were not the case, the rate of return would obviously be lower,

with 14% for a minimum of 126,000 pupils reached.

The Colombian project is somewhat older, the first loan having been made two years ago. Construction of 10 large secondary school units is well under way. When finished next year, they will accommodate 48,000 students on a two shift basis.

The potential impact of the Colombian endeavor is twofold: A more pertinent type of schooling and greater educational opportunity, both from a geographic as well as a social standpoint.

Traditionally, Colombia has relied heavily on secondary education that stresses preparation for university studies. This has tended to benefit upper class groups primarily. Schools the Bank is financing will be comprehensive institutions, providing options in agricultural, commercial, industrial, social welfare and health subjects. Students will thus be better prepared for employment or further technical as well as general training.

The schools are being built throughout the country. More important, students will not be forced or "streamed" into tracks, or special channels of instruction at an early age. Experience has shown that this tracking

tends to discriminate against pupils from poorer backgrounds. They often have difficulty making the transition. When this happens, performance suffers and they invariably drop out. The comprehensive school, delaying emphasis on a special track until later, is an attempt to surmount this difficulty, and to widen education opportunity.

One of the most heartening features of the Colombian project is the enthusiastic response of the people. We seem to have developed a true partnership there in educational planning and development. And one of the best signs of its success is the fact that the first school in the project -- a school in Bogota with 5,000 places -- was inaugurated more than a month ago. This is, by any standard, very rapid implementation.

Another interesting aspect of the Colombian story is that the schools in the project are deliberately designed to be used on a double shift basis. The reason is to help strike at some peculiar demographic problems and to exact the greatest possible benefit from the investment.

The demographic problems result from Colombia's rapid population growth -- 3.2% a year -- which has forced a downward shift in age distribution.

In 1951, those 15 years old and under formed 39% of the population. This proportion rose to 46% in 1964. Another demographical force is the shift from rural to urban areas. Between 1951 and 1964, rural population declined from 61 to 48% of the total and this pattern is likely to continue.

Secondary school enrollment is still very low for a country in Colombia's stage of development. It is only 15% of the relevant age group, compared with 40% in Argentina, 28% in Venezuela, 22% in Brazil. Private secondary schools offer more than half of the available spaces but it is estimated that only 10% of the population can afford them since it costs about $60 to $85 a year in a country where per capita gross national product (GNP) averages about $300 a year. Thus, the fortunate 10% have access to 20 times as many secondary school places per capita as the other 90%.

The Bank's project, therefore, is designed to help correct some of this imbalance of educational opportunity. But given the magnitude of the problem, it was decided to design the schools for double shift use, mornings and afternoons. To help make this possible, there will be two shifts of guidance counselors, two sets of teachers with adequte space for offices, supplies and the rest. The result is that each classroom

will be used 55 periods a week instead of 35. On an economic basis over-all benefits will be enhanced in relation to costs. But more important, 48,000 young people will have an opportunity that never existed before to get some schooling.

I should point out that in addition to lending for specific education projects, the Bank also provides technical assistance. One of our missions, for example, undertook a detailed analysis in 1967 of certain aspects of the University of East Africa and its development plan. Although there were no construction loans or credits involved, the analysis did expand the fund of knowledge about limitations imposed by resource constraints. And it suggested qualitative changes that would maximize the productivity of the educational system. For instance, it was suggested that certain physical facilities could be better utilized, that the student-teacher ratio in some faculties could be increased, that teaching loads of certain professional staff were too low, that there was a risk that the university system was expanding faster than the supply of secondary school graduates. This analysis served as a background document for a donor conference later in 1967 to discuss additional aid to higher education in East Africa. These procedures, we feel, have contributed greatly to the emergence of a far more realistic framework for intelligent deliberation and policy making.

I certainly do not mean to imply with this discussion that the Bank, in its development strategy and project lending, has found the path to some educational El Dorado. It hasn't. Education constitutes just one, albeit very important, segment of the broad scenario of modernization.

And there are no quick, easy realistic answers in this field. The Bank's role in the total scheme of things is relatively minor. But we intend to make a greater contribution. And we hope that our real impact can be measured not so much in dollar volume or numbers of projects but in catalytic force, by searching out innovations, in probing for new methods that, once proven, can help inspire people to undertake their own reforms.

We cannot say that an investment of x dollars in education will produce a y result in social and economic development or growth. All we can predict is that a well educated and motivated people have a better chance to do well. History has repeatedly shown that education does contain seeds that can inspire and energize a whole people.

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Freedom for what? Essentially the only freedom worth anything to an individual is to select those activities through which his latent capacities achieve fullest development. The Greek ideal of a sound mind combined with

a sound body still has validity. And though it still is only a distant ideal for the majority of people in the poorer countries, it remains a reliable star by which struggling mankind can set its course.

This, then, is what I perceive to be the essential role of education in development. To help extend the freedom of the individual. This is the challenge. And the hope.

Thank you.

Mr. William Clark

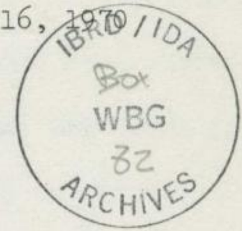
INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

Monique

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: June 16, 1970



FROM: Irving S. Friedman

SUBJECT: Address to The Canadian Manufacturers' Association

You may be interested in glancing at the attached address which I gave to the Canadian Manufacturers' Association on Monday, June 8.

The parts in brackets are those which I did not read in an effort to keep it down to the 25 minutes allotted for the address.

ISF

cc: Mr. William Clark

copy sent to Paris
" Don Towson
Jan 13/1971

Address to

The Canadian Manufacturers' Association

99th Annual General Meeting

"Patterns of Trade and the Forces of Change"

by

Irving S. Friedman
The Economic Adviser to the President

Montreal, Canada
June 8, 1970

PATTERNS OF TRADE AND THE FORCES OF CHANGE

For a country such as Canada that depends on export markets for over one-fifth of its total output, it is not surprising that foreign trade should be a subject of lively interest even in ordinary times. However, as we all know, the times are not ordinary; to borrow a phrase, the times are out of joint in many countries. Existing policies on foreign trade as well as others are coming under the closest scrutiny and attack from certain quarters. Unfortunately, there is no guarantee that we won't make the wrong decisions in foreign trade policy. The people at this Conference will be important in deciding the future trade policy not only of Canada, but also of the world. This gives great importance to your deliberations today. This is not new since Canadians, such as Mr. Warren and others here today have played a major role in shaping the traditional policies of the Western world in the field of international trade.

The basic foreign trade policies that have guided Canada, the United States and other countries for the past 25 years are enshrined in two international instruments adopted at the end of World War II -- the General Agreement on Tariffs and Trade, the so-called GATT, and the Articles of Agreement of the International Monetary Fund. The GATT and Fund principles have served us well -- as witness the unprecedented rate of expansion in world trade and output over the past quarter of a century.

What then are some of the basic new forces on the world scene that impel us to reassess our traditional policies? Let me simply mention a few:

1. The emergence of a new preferential grouping, the European Community, as the world's single most important trading unit and the possible expansion of the Community to include the United Kingdom and most of the other members of the European Free Trade Association). on the

2. The clear demonstration that, despite a quarter of a century of trade liberalization under the aegis of GATT, practically no progress has been made in opening up the world's markets to agricultural trade. It is no exaggeration to say that the trend has run the other way.

3. The rapid expansion of the role of the multinational firm which has called into question the very premises of traditional trade policy -- namely that goods move across national frontiers but factors of production are relatively immobile as between countries.

2. [4.] The world-wide acceptance of the need to accelerate the growth of the low-income countries, and the general consensus that trade policy as well as international flows of capital should be consciously adapted to facilitate the achievement of this goal.

3. [5.] The continued presence of strong inflationary forces in a number of the developed as well as developing countries. These inflationary forces have resulted in rapid shifts in international cost and price relationships, in increasing the difficulties in managing successfully the balance of payments of such countries, as well as undermining efforts to maintain satisfactory employment and income levels together with equitable income distribution.

4. [6.] The emergence and persistence of relatively new major problems affecting the entire pattern of private and public expenditures and savings, such as urbanization, pollution, public reaction to remaining areas of poverty and high level defense expenditures in some countries. All of these have serious implications for internal resource allocations as well as taxation within industrial countries and, therefore, on the pattern of domestic production and consumption and, therefore, on the foreign trade of a country.

Each of these new elements is really descriptive of a whole new set of problems affecting international trade, and time will not, of course, permit me to elaborate on them all. In a moment, however, I will say a word (based on my past and present experiences) about two: namely, the developing countries and something about the relationship between trade policy and international finance. But first, let us briefly mention some of the outstanding trends that have characterized international trade since the end of World War II.

Perhaps the hallmarks of the era that we have been living in since the end of World War II are dynamism and change, that have prevaded all sectors of life and society and all fields of activity. International trade has been no exception. [Most regions and countries have gained from their participation in an unprecedented expansion in international trade, though I must hasten to add that the economically weaker countries have been the ones to receive the smallest shares in the benefits.]

The most dramatic indication of dynamism in postwar world trade is the acceleration in its rate of growth following World War II, as compared to its long-run growth rate during the preceding 75 years. Very long-run comparisons of economic data must always be treated with caution, but the orders of magnitude are meaningful. World trade in value terms grew at an average rate of around 3% per year over the entire period from the late 1870's to the prewar peak of 1929.

The Great Depression of the 1930's then took its toll and the value of world trade dropped by over 60% within three years and continued declining more slowly for another two years. It did not recover to the 1929 level again until 1948.

Since 1948, or better still 1953 (to reduce the effects of the post World War II recovery period and the Korean war on our data), world trade has grown at an explosive pace compared to the past rates just cited. Between 1953 and 1969 world exports in value terms (excluding the centrally planned countries) expanded at an average rate of nearly 8% per year, or nearly three times as fast as during the period

from the late 1870's to 1929 -- not to mention the dark 1930's.

The long-term postwar rate of expansion means that in effect world export trade has been doubling in value, and more or less in volume, every ten years. In 1969 world exports took an especially big jump of more than 13% over 1968 in value (and 8-9% involume) and reached a level of about $270 billion (including the centrally planned countries); twice what it had been only eight years before in 1961 and four times the annual level reached 20 years ago. Thus each year the world is now providing -- and what is perhaps more striking and significant absorbing -- close to $30 billion's worth of additional export trade.

To comprehend the significance of this tremendous increase in the overall growth rate some background on the recent structure of world trade may be useful. Relatively complete country and regional details on world trade are available only through the year 1968 at this time, but that year should give a fairly valid picture of the present structure of this trade.

Of the approximtely $240 billion's worth of exports (f.o.b.) that took place in 1968, over 70% originated from the developed countries (the United States and Canada, Western Europe, Japan, South Africa, Australia and New Zealand); about 18% originated from the developing countries and just under 12% came from the centrally planned countries.

These rather broad economic groupings can be broken further into more institutionalized and, in fact, economically more significant trade groupings, among which the most important is the European Common Market. That grouping accounted for around $64 billion of gross exports (including its own intra-trade) or about 27% of world trade. The European Free Trade Area's (EFTA) gross exports were roughly half as big as the Common Market and those of the Council of Mutual Economic Assistance (CMEA), comprising the USSR and the Communist countries of Eastern Europe (except Yugoslavia), accounted for 10-11% of the total.

In this picture of economic, institutional or geographic "regionalization", one cannot neglect the outstanding importance of certain industrial countries. The United States alone accounts for around 14% of total world exports, Germany nearly 10%, the U.K. over 6%, Canada with over 5% of world trade is at the same level as France and Japan and, in fact, ahead of the USSR.

Worthy of special mention has been the marked tendency in the postwar world toward "regionalization" of export trade, both in a geographic and an economic sense, even where no legal or formal institutional framework was present. Thus among the developed countries as a whole the share of exports to each other in their total gross exports to all destinations increased from 70% in 1955 to 76% in 1968; conversely trade among the developing countries has proportionately declined.

Among the more institutionalized trade groupings, the movement toward trade regionalization has been much more pronounced and the most dramatic record has been made by the European Common Market. The share of intra-trade exports in this group rose from 33% of their aggregate gross exports in 1955 to 45% in 1968. In the case of the European Free Trade Area, the share of intra-trade in total gross exports rose from 19% to 24%.

The Commission on International Development, headed by former Prime Minister Lester B. Pearson, recommended that the developing countries take steps to expand trade among themselves; their trade is now very small. The experience of regional trade arrangements suggests that developing countries may expand trade best among countries economically linked by transportation, banking, communications, etc., rather than over broader and looser regions, such as the Latin American Free Trade Area.

In assessing the basic forces at work in international trade, some mention must also be made of the changes in the commodity composition of this trade.

Almost two-thirds of world exports consist of manufactured products, and this group has been the most rapidly growing sector of foreign trade. Machinery and transport equipment have been outstanding performers. Since 1960 the developing countries actually have fared better with their exports of all manufactured goods which have expanded in value at a rate of almost 10% per year, but these still account for only 20% of their total exports, having started from a very low level. [Moreover, exports of manufactures still originate from a relatively small number of the less developed countries -- most of the less developed countries export virtually no manufactures. Indeed a number of the developing countries which export some manufactures are already in a transitional stage out of the category of developing countries into the category of developed countries. For example, Mexico, Yugoslavia and Argentina.]

As for the remaining approximately one-third of world exports of goods, namely the primary commodities, their performance has lagged much behind manufactures. This group of products as a whole has managed an average global growth rate of only 4-5% per year in value since 1955. In dramatic contrast with manufactures, volume grew faster than value, reflecting the deep-rooted and long enduring problem of adverse terms of trade for primary producers. [I will return to this point in my later remarks concerning the differences experienced between the developed and the developing countries.]

Even if it were possible to provide a full explanation of the present geographic and economic structure of world export trade, it would be beyond the scope of my talk this afternoon. A major role undoubtedly has been played by the strong and prolonged surge of income growth of the postwar era. U.N. estimates indicate that aggregate world GDP in real terms has been growing at over 5% per year since the mid-1950's with the rate accelerating to over 5½% per year in the 1960's. This rate of growth over a sustained period is unprecedented. Similarly,

industrial production has increased between 5-6% per year for two decades. It is to be noted, however, that in the last two decades the expansion of world trade has been much greater than the expansion of output or industrial production; while in earlier years the reverse situation had persisted. After nearly 200 years of the so-called "industrial revolution," the world is now reaping greater benefits than ever before through a rapid acceleration in the exchange of goods and services.

A second factor accounting for the rapid increase in international trade is the development of modern applied technology and its effect of creating new products as well as new demands to absorb them. [One need only visualize the array of materials, semi-processed and end-products, that support modern life and compare them with those available, say, seventy or even thirty years ago. The technological revolution, including marketing and management techniques, strongly continues.] The consequent specialization among countries required to produce and use this stream of new products and processes no doubt explains in large part the rapid rise in the international exchange of manufactured products.

Another essential ingredient in the postwar trade situation, and one that has been unique in history, has been the development of an institutional framework for achieving a cooperative, multilateral management and coordination on a global scale of national monetary and commercial policies with a view to facilitating and promoting the expansion of international trade.

Indeed, one of the primary purposes of the new international monetary mechanism established after World War II was to avoid the debacle of the collapse of international trade and reversion to the protectionist trade policy

which had characterized the 1930's. Unfortunately, the proposed international trade organization never came into existence. Instead of a fully fledged international trade organization with its own international agreement of obligations and rights as represented in the so-called Havana Charter, we had the General Agreement on Tariffs and Trade, the so-called GATT, which started with severely limited authority and staff.

I would like to pay tribute to the work done by the GATT. It greatly exceeded the expectations of those of us who advocated the creation of an organization vested with important international authority. The GATT despite its constitutional limitations, which still inhibit its effectiveness, has proved to be a useful and indeed indispensable mechanism both in promoting greater expansion of trade by achieving reductions in tariffs and other impediments to trade and in limiting restrictive trade policies and practices which may otherwise have resulted particularly from past international financial crises or changes in domestic business conditions. The new problems mentioned earlier such as the expansion of intra-regional trade present new situations and problems with which the GATT is already deeply concerned.

The International Monetary Fund has also devoted much of its efforts to achieving a liberalization of trade. This it has done directly in bringing about a relaxation of exchange restrictions and reduction in discriminatory practices, and indirectly in cooperating with the GATT with respect to quantitative restrictions when balance of payments difficulties compel their use by individual countries. The Fund has encouraged the use of its financial resources to achieve relaxation of restrictions and the convertibility of currencies, thus eliminating the monetary basis for discriminatory exchange and trade practices. Many here will recall the impact of the Fund's efforts in the 1950's to achieve the elimination of discrimination against so-called dollar exports from Canada and other countries in the dollar area. The Fund's members have also made repeated use of their access to Fund resources to defend realistic exchange rates, which are of vital importance in linking the monetary and financial systems of countries with one another and, therefore, are critical to all international economic relations.

One of the vexing problems of the postwar period has been the difficulties which countries have found in adjusting exchange rates to reflect truly the position of the country concerned with the rest of the world economy. Countries have met this problem in various ways such as using fluctuating or floating exchange rates instead of fixed rates. Over the years countries have also shown ingenuity in developing techniques outside of the exchange system such as temporary general import surcharges or granting rebates on export taxes when exchange rate changes were not regarded as feasible or appropriate, and yet it was clearly recognized that monetary relations in the country concerned were at least temporarily out of line with the rest of the world, causing unacceptably large balance of payments surpluses or conversely, unacceptably large deficits. The efforts of the Fund and the GATT have helped to keep such practices temporary and this has indeed been a major achievement of both institutions.

The recent creation of Special Drawing Rights in the International Monetary Fund, by increasing the liquid resources available to countries to finance balance of payments deficits, has strengthened the mechanism for providing a suitable environment for the growth of world trade. Thus, the International Monetary Fund has proven to be a flexible institution capable of coping with a great variety of circumstances, while at the same time adhering to the fundamental principles on which the system is based. There have been exceptions, when needed, but they have usually been temporary in those countries which are of major importance for the international monetary system.

Much is heard these days about different techniques for adjusting exchange rates. Canadian history is rich with experiences in this field. My own reading of economic and financial history is that we should not be too mesmerized by techniques -- the ingenuity of man has indicated how innovative we are when necessity demands a new technique or an alteration in an old one. We should not be forgetting that techniques are instruments of policy -- they are not policies in themselves. Our aim should be to achieve the benefits of world trade, the acceleration of development in less developed countries, the combatting of inflation, agreed national priorities, and so forth. These are objectives and having agreed on objectives, we should always be willing to consider whether existing techniques help us to achieve them. We cannot escape from the reality that from time to time any technique may prove politically difficult to use. At such times other techniques may be attractive and useful, but care must be taken before tried techniques to which the world economy has become attuned, are drastically altered. Because of my poast experience I may very well be biased, but I sincerely believe that the Fund Agreement can provide the world, as it has in the past, with a successful international monetary system for an expanding world economy and satisfactory growth in world trade. This international monetary system is a precious asset which we all have an important interest in defending. The present difficulties which now confront some major developed countries like the United States are not, I believe, attributable to deficiences in the international monetary system.

The Fund and the GATT are the principal and, by now, the oldest institutions in the field of promoting international trade, but I would be remiss in not mentioning some others whose primary instruments are not financial resources or a legally binding set of international rules and agreements but rather moral suasion and the achievement of consensus. Such institutions are UNCTAD, the trade-oriented bodies and study groups of FAO and the continuous international commodity study groups. There are also the international commodity councils

that govern trade in certain major commodities, namely, coffee, wheat and tin. Indeed, I would also mention the World Bank Group, since the bulk of over $2 billion or so annual lending helps to finance the sales of capital goods in international trade and many of the projects financed by the World Bank Group increased the export capacity of developing countries through diversifying their economies and, where appropriate, improving the efficiency of traditional exports.

The significance of this wide network of international institutions in the field of trade is hard to assess precisely. It seems a fair conclusion, however, that the growth in trade could not have been so great, steady and sustained, in the absence of these mechanisms which facilitate continuous international contact, discussion and collaboration on the problems that arise as well as provide financial assistance when needed.

While we may look with satisfaction and optimism at the achievements of world trade in the postwar era, however, and indeed its prospects for the future, we might well be mindful that the overall picture conceals important problems -- some longer-run, some immediate.

One problem that I feel particularly bound to call to your attention is the uneven participation by the two major economic classes of country in the benefits of an expanding and increasingly affluent world economy, of which an important part is the rapidly rising international trade which has been described. We have already mentioned that the expansion of trade of the developing countries has been much less than the expansion of the developed countries.

The major proximate causes of this situation have already been alluded to and are well known. The developing countries' export products consist of a relatively narrow range of primary commodities which, with very few exceptions, face a variety of problems. Many of the foods and beverages, for example, face relatively sluggish demand growth. Many of the industrial raw materials face

competititon from man-made substitutes. Many products in both categories face problems of access to the import markets due to protective tariffs and quantitative restrictions. Yet foods and raw materials alone comprise upward of 50% of the total exports of this group of countries as a whole.

The exports of the less developed countries have, moreover, had to face a generally falling price level. Only because of highly unusual price movements in 1969, due to such factors as the continued rise in cocoa prices, and the sharp increase in prices of coffee and non-ferrous metals, was the price level for that year approximately the same as in 1953. Because of the difficulties facing this trade, the Bank and the Monetary Fund devoted much effort in 1968 and 1969 to the study of the problem of stabilization of primary commodities. Suggestions were made as to ways in which these institutions might find solutions to this problem. On the Bank side the primary observation was that no single, or simple, remedy exists for this problem; the basic and lasting solution is economic development of the less developed countries. A number of specific activities, however, were identified by the Bank which could make a significant contribution to the solving of the commodity problem, including not only loans for diversification of economies but also such activities as promoting high priority applied agricultural research.

I should hasten to add that a major role in assuring a greater participation by less developed countries in the benefits of an expanding world trade will fall on these countries themselves, assisted by external development finance sources such as private capital, the World Bank Group, the regional financial institutions and bilateral assistance programs. One lesson that is clear from the record of trade expansion in the postwar world is that diversification and industrialization are a basic condition of trade expansion. It is very hard to take full advantage

of the expanding world economy when, say, only three commodities -- other than petroleum -- account for half or more of total exports, as is the case for the great majority of the developing countries. Only the capacity to produce a growing and varied volume of manufactured and non-traditional agricultural products for export on a competitive basis will open up for such countries the same kind of opportunities for expansion that are being enjoyed by their developed counterparts, both regionally and globally. Development strategies designed to achieve such objectives can be devised. [Their implementation requires carefully conceived and courageously executed fiscal, monetary, exchange rate, foreign investment and foreign trade policies, as well as greater willingness to implement decisions taken by some in favor of regional cooperation and integration. These policies are, however, at least as difficult to evolve and pursue in the developing countries as in the developed countries. We cannot be unrealistically impatient, but we can insist that development be the number one national, economic and social priority in nearly all of the developing countries.] There are a number of success stories; current examples of success in this direction are the performance of such countries as Colombia, Singapore, the Republic of China and the Republic of Korea.

The assurance of continued success for these and the other developing countries will require an enlightened and flexible commercial policy by all countries, particularly the major trading ones. Occasional difficulties resulting from exports from newer sources of supply should not becloud the basic fact that a very large increase in exports of manufactures from the less developed countries could be absorbed without generally upsetting the economies of the developed countries; indeed such exports from the less developed countries could contribute to even faster growth rates in the developed countries. It is understandable that even in developed economies certain sectors may sometimes require a transitional period to adjust to competitive pressures. It is important, however, that resort to constraints on trade in such cases be sparing

and in most cases temporary. I trust that it will also be possible to implement the various resolutons which have been taken granting tariff concessions to developing countries on a non-reciprocal basis. I do not underestimate the difficulties in achieving trade liberalization, but the difficulties are in direct proportion to the importance of liberalization, and this is doubly so for the developing countries. We cannot forget that in the final analysis access to market and prices obtained for their commodities are of critical importance to these countries. 80% to 85% of their foreign exchange receipts come from trade and these receipts must increase if the development effort is to succeed and their creditworthiness for external borrowing maintained. Foreign aid or private investment can provide only a small share of the foreign exchange needed - the bulk must come from trade.

On a more general plane, we all face the problem of continuing to improve the postwar system of international trade and making it work. Our stakes in doing this are high and are increasing. If world trade were to continue growing at the postwar rate, it could reach a level of gross exports of over $500 billion a year by 1980. It could be even much higher if the exports of the developing countries fulfil their potentials. [This increase is not only worth reaching in itself, but such an achievement surely would give all countries a valuable margin of maneuver in managing their domestic economies both to sustain high growth rates, combat inflation and improve the quality of life.] The rapidly growing economies of the future, I believe, will be those which look outward and exploit to the fullest the opportunities of this greatly expanding international trade -- and this applies to both the developed and developing economies.

We have come to take for granted expanding international trade, with its many major benefits; the difficulties, such as those besetting some countries today could bring serious set backs in foreign trade policies. A rapid expansion in foreign trade will not be so in the future unless we pursue policies designed to keep it so.

Thank you.

J. Friedman. Dec 4, 1971 - Colombo, Ceylon

DEC 14, 1971

Dilemmas of the Developing Countries: The Sword of Damocles

I am indeed deeply honored and privileged to address your Association. I need not tell you the important role which science plays in modern life. I will instead try to address myself to some problems of the lower income developing countries to which all scientists can contribute.

It is important when addressing any group of scientists to make clear the point of view which one brings to problems. In dealing with questions of public policy, I do not believe that a social scientist should strive for so-called neutrality. His objectivity should be in his concern for truth and validity. In his application of truth, as he sees it, he must be guided by a concern for people. If he tries to live on Mount Olympus he may find the view of nature more beautiful and attractive, but his vision of human reality becomes blurred and obscure.

Allow me to introduce our subject today by recounting the familiar story of the Sword of Damocles. You will recall the well-known Greek tale that during the period when the City-State of Syracuse experienced great prosperity and well-being, one of the courtiers praised the head of state, Dionysus, and congratulated him on the wealth of Syracuse. This courtier was named Damocles. The next time that Damocles and other guests came to have dinner with Dionysus, Damocles found a sword suspended by a thread hanging over his dining place. Dionysus explained to him and the guests that the sword had been placed there not as an unfriendly gesture, but rather to remind Damocles and all others how fragile was the prosperity of Syracuse and how dangerous to become complacent about its existing good fortune.

The story of the Sword of Damocles has come down through the ages because the truth remains valid for all time and all people. Prosperity and power are always in jeopardy and complacency leads to neglect of realities. The danger of complacency is greatest when things seem to be going well.

It might well be asked what is the relevancy of the Sword of Damocles in the world where complacency finds it difficult to exist, except for those who simply refuse to look at the realities of life. The modern world abounds with troubles and particularly in addressing scientists in a developing country it may seem especially inappropriate to repeat a tale which seems addressed to prosperity and the dangers of complacency.

However, I do tell the tale because for me it has a much deeper significance than the one that is usually given to it and a deeper significance which is relevant for the developing countries and the modern world. I see in the tale the moral that not only is success fragile but that success itself creates its own problems. For the problems of Syracuse which finally led to its

downfall were not those conditions which had to be overcome in making Syracuse rich and powerful, but rather new ones which arose in the process of its being rich and powerful.

Thus, in the developing countries we have two sets of problems: those which are inherited from the past and those which are generated by the process of change. These two sets of problems interact and intertwine becoming one thread from which we suspend the dangerous tensions which threaten the progress of our societies.

The changes in our societies frequently represent real triumphs and successes due to the strenuous efforts of the people involved in these changes. However, we cannot have these successes without also having the problems which they create. In a world of modern technology, the process of change is swift compared to previous periods of history. There is not a relative slow movement from the past, to the present, to the future. Instead the past, present and future all live intermingled with one another and interacting in a manner which baffles human ingenuity either to diagnose or to cope with efficiently.

In theory, there may be a choice between the acceptance of things as they are and acceptance of change and the consequences of change. Whether scientists, or business people, or political leaders, we may often feel the desire to escape from the dynamics of change, as we face the repeated frustrations of living with the consequences of these changes. However, there is no choice but change and the reason is simple. The reason is that existing conditions of much of humanity and existing trends for all are simply intolerable and unacceptable. The central mission of all of us is to change these existing trends because their realization would be a disaster for the human race; what is more likely is that the present unfavorable trends will not materialize but, instead, disorder and violence would become commonplace, with unknown consequences for all. The meaningful questions relate to the content, mechanism, timing and feasibilities of changing existing trends. It is for this reason why science is so central in our lives, because in deciding these questions of content, mechanism, timing and feasibilities, all scientists have a major contribution to make and no scientist can choose not to be part of the process of decision.

Let me quickly review the picture in the developing countries to substantiate the view that present conditions and trends are simply not tolerable. Perhaps I should say, in advance, in addressing a scientific community that the available facts and other kinds of evidence are frequently poor. As social scientists we have not done enough to accumulate the necessary knowledge for firm judgments in this field whether these judgments be of an analytical or theoretical character or judgments on policies and remedies. Much more effort must be devoted to improving our knowledge. The errors we are bound to make repeatedly

because of our lack of ascertainable knowledge are much more costly than would be the cost of the efforts to improve our knowledge and reduce the likelihood of error. Nevertheless, despite this important qualification, there is enough evidence for important generalizations.

The majority of mankind lives at a level of income which can only be described as too low to sustain a truly human existence. The average per capita income in Asia is in a magnitude of $110 per year per person. In 1960 it was $90. Not only is the $110 intolerably low, but unless the trend is changed it will only be $200 per year by the end of the century. The millions living in Africa are in the same condition. In Latin America conditions are better, but even there, the average per capita income is about $375 per capita and the rate of improvement very low. As a basis for comparison, we have average per capita incomes in Germany of over $2,000 per person and over $4,000 per person in the United States. Of course, these are not strictly comparable figures, but, however corrected, there still remains the tremendous disparities in the ways of life which such differences in per capita income reflect. Moreover, we are talking here about averages. A large portion of the more than three billion people in the world live below these averages even though they work hard.

Furthermore, we have long come to recognize that per capita income or product is by itself not to be taken as an indicator of individual or national well-being.

As we dig more deeply into the story of poverty in the developing countries, the results become increasingly more unbelievable; they take us out of the comfortable abstractions of income and product into vivid realities.

Malnutrition, as we all know from our personal experience and observation, is widely experienced in the developing countries. Countries with low per capita income are typically those most likely to have a calorie or protein deficit in food supplies. By the established FAO standards for calorie intake, the more developed countries average over 10 per cent above these standards. Asia is below these standards. Similarly, findings of studies done suggest considerable discrepancies within countries. For example, looking at regional differences, 75 per cent of rural families in the backward northeast Brazil had less than the estimated average calorie requirement of 2,450 calories per day, while among the rural families in South Brazil the corresponding proportion was only 3 per cent. Moreover, differences in income have considerable effect on the nutritional adequacy of diet. Poor households in less developed countries experience diets which are grossly inadequate, both in calorie and protein components. The general prevalence of malnutrition is dramatically summarized in the FAO and WHO estimate that as many as two-thirds of all surviving children in the less developed countries have been malnourished. Our doctors, physiologists and biochemists can tell us much better than I can what this does for the ability to lead a happy life, to learn and to achieve spiritual fulfillment.

Similarly, the statistics for deaths reflect the impact of poverty -- national and individual. In the more developed countries, deaths average nine per thousand; the corresponding figure for the low-income countries is sixteen per thousand -- 75 per cent higher. In India, there are large areas where deaths in the first year of life are equal to 15 to 20 per cent of those surviving birth. In Egypt, the proportion of children between the ages of one and two who die is more than 100 times higher than in Sweden. In Pakistan, the percentage of children between the ages of one and four who die is 40 times higher than in Japan.

Infant mortality also reflects these shocking differences between the fate of one conceived in a poor country and one conceived in our more affluent countries. In Brazil, infant mortality is 170 per 1,000 live births, in India and Pakistan it is about 140 per 1,000 live births, 48, I'm informed, in Ceylon and 20 in the United States. Thus more than 8 times as many infants die in birth in Brazil than in the United States, and in this respect, the United States is somewhat "backward" compared with a number of other industrialized countries like Sweden, Japan and France.

It is not surprising in light of these kinds of facts -- and they are only examples of many more -- that in France and Germany the ratio of doctors to people are one doctor to 850 people and one doctor to 650 people respectively, while the corresponding figures for Asia are more like one doctor to 4,000 or 5,000, while in Indonesia, it is reported that the ratio is one doctor to over 25,000 people -- nearly unbelievable.

As we observe the housing in which our poor live, as well as their nutrition and lack of medical care, the mortality figures become more believable. In Mexico, a country which by many criteria has done well in social and economic development, only about 30 per cent of the homes have piped water inside or outside homes; similarly in the Philippines. In Brazil, another less developed country which has made considerable progress in modernization, only about 20 per cent of the homes have piped water and less than 40 per cent of homes have electricity. In the Philippines less than 25 per cent of the homes have electricity. In the industrialized countries, we commonly find percentages for piped water and electricity in homes which are close to 100 per cent. Even these figures don't describe the full realities. For that we need to observe with our eyes and smell with our nostrils. Even to use words like "housing" to compare conditions between rich and poor countries is often to obscure the realities.

If we add to the statistics on nutrition, disease and housing, those on education and literacy, the causes of widespread despair in the developing countries become self-evident. The more developed countries have literacy rates for adults of close to 100 per cent;

in the less developed countries, the median literacy rate is about 50 per cent. The more developed countries also have 5 to 10 times as many graduates with higher education and the figures for education with needed technical skills are even more dramatic.

In more recent decades, this inherited poverty has been enhanced in its horror by the impact of urbanization -- reflecting one of the first responses of an agrarian society to industrialization and modernization, but now coming without adequate preparation and at a pace which has overwhelmed those trying to deal effectively with the problem. Merely to visit the great urban centers of the world is to see that they are becoming things which no longer can be called cities -- for millenia the centers of cultures and civilizations.

Already nearly 650 million people in the low income countries live in urban areas and this figure is expected to reach one billion by the end of this decade. By 1980, the urban population in the low income countries is expected to exceed the urban population in the higher income countries. And in the high income countries, with all of their wealth and capacity to produce, the urbanization problem is overwhelming one community after another. The consequence is a special form of poverty, urban poverty, which creates dehumanized environments of a kind that is quite different from the already appalling physical poverty of the countryside from which millions are fleeing into the cities in the hope of a better way of life, only to find themselves caught in a different trap.

However, all of these facts could have very different implications for the future of the hundreds of millions concerned were it not that their current plight is compounded by the existence of chronic large scale unemployment and little hope, at present, for improvement. Present poverty, including poor nutrition and housing as well as inadequate education and illiteracy, would be much more tolerable if there was the prospect of gainful and productive employment. While unemployment problems in the developed countries may be regarded as a special aspect of the general employment problem, unemployment in the less developed countries can be regarded as a special aspect of the problem of poverty and population growth.

We used to be greatly concerned with how much capital the less developed countries could effectively absorb. My own studies indicated another $5 to $7 billion per year could be used from external sources. The problem of lack of capital is still of fundamental importance; more capital could greatly facilitate the solution of many economic and social problems, including improving the adequacy of food supplies. However, the focal points of interest have now moved to whether productive ways can be found to absorb the surplus manpower being created by the large increases in population and how to improve the conditions of the poorer of the working poor.

The starting point, as in so many other problems in the less developed countries, is the large rates of growth of population. Despite the relatively high rates of infant mortality and lower life expectancy in the less developed countries, infant mortality rates have declined and life expectancy has lengthened, both salutes to the successful application of modern science. The resulting population increase means that there will be a 25 per cent increase in people wanting work during this decade in the developing countries, as compared with a 10 per cent increase in the developed countries.

There is, as yet, no likelihood that increases in employment opportunities will come even close to these 25 per cent increases in the numbers seeking work.

The first possibility which suggests itself is increases in employment in manufacturing. Unless there is a drastic change in existing trends in nearly all lower income countries, it cannot be expected that expansion in manufacturing employment will have more than a marginal impact on total employment. Until now, instead of entering what may be called the modern sectors of the economy, people have gone into sectors which in most developing countries have been stagnant or slow moving, namely traditional agriculture and handicraft manufactures and into low productivity service activities. Many, if not most, of these people, have probably not shared in the increases in real national products which most less developed countries have experienced during the past year. Thus, we see repeated examples that there is developing a sharp dichotomy between the more privileged groups of urban workers and employers in the modern sector and others, who are still usually a large majority, in the more traditional sectors. Thus, the growing gap between the rich and poor nations is paralleled by growing gaps within the poorer countries, a condition which handicaps the growth of the modern sector as well as creates political and social tensions. Questions of distribution of income is of prime importance in all economies, but it has a particular importance in the less developed countries. Creating higher incomes for much larger sections of the population is not only socially desirable but is a prerequisite for accelerated economic growth without which poverty cannot even ultimately be greatly reduced, if not eliminated.

In addition to the huge wastage arising from the fact that employment is often disguised under-employment, even in the cities as well as on the farms, a very high level of open unemployment already exists, mainly in urban areas, and especially among young people. And often these young people are relatively well educated. As noted earlier, this is happening under conditions where urban areas are already growing much more rapidly than population. Thus, the problems of poverty, heavy unemployment and under-employment and extreme income inequality are combined. They have to be faced and attacked simultaneously.

In the past, there has been deep concern that emphasis on employment creation would result in labor intensive development. This could represent a less efficient way of using scarce capital and reduce the rate of economic growth, which has been seen as essential to the attack on poverty. Now, faced with the realities summarized very briefly, particularly the growing unemployment, we are trying to find new strategies in the major productive sectors of industry and agriculture which might provide more hopeful avenues to resolving this dilemma.

Until now the underdeveloped countries have chosen policies which concentrate efforts on building a modern industrial sector -- islands of modernity -- where the use of capital and technology is patterned after the industrialized world. Frequently this modern industry has, however, been less efficient because the markets for output are often limited to domestic markets. Even low income countries with large populations are very small when considered as economic marketing units compared with even the small and medium-sized industrial countries. Therefore, producing for domestic markets in low income countries does not allow the same economies of scale as in the industrialized countries or in these industries in less developed countries producing for export. Modern industrialization is made possible by all sorts of protective devices to keep out cheaper foreign manufactures. In these modern sectors, relatively high wages have attracted more laborers than could be used, adding both to the open unemployment problem and to the urbanization problem. It seems safe to say that less emphasis on industry as a whole and more on agriculture would have resulted, in the lower income countries, in more favorable trends in employment, income distribution, and urbanization and perhaps even in total output growths including agriculture and agricultural based industries.

There is now much more thought being given to finding new productive techniques, usually referred to as intermediate technologies, which can increase output and income of the poorer groups while reducing unemployment and slowing down urbanization.

Thus, unless policies are adopted which are much more successful in increasing savings and directing them to productive activities which better serve the objectives of reducing poverty and unemployment, the scope for improvement in earnings and employment is very limited, at least in the short run. Again, we turn to the question of poverty, particularly the poverty of the poorest groups. For these groups, the prospects are bleak indeed for any improvement and the question arises will a developing country be able to persist in any development program under such conditions.

The need to deal with the political and social consequences of existing trends fall mostly on the shoulders of governments, not scientists. But scientists have a major responsibility for the

understanding of the problems, their effects and possible solutions. Already, there are many alternatives made possible by modern science and technology which have not yet been fully explored or implemented. Scientists can also open up new alternatives based on new comprehensions coming with new knowledge, as for example in family planning, technological research on new agricultural crops suitable for non-irrigated agriculture, the development and use of intermediate technologies and compilation of more satisfactory data on employment and occupations, income distribution, population, prices, costs and so forth.

Although the scientific community and some others appreciate the need for more research, in practice very little resources are spent for this purpose, particularly in the less developed countries. For example, in the agricultural sector, the most important sector in the developing countries, in which the potentials for greatly increased income are well recognized as evidenced by the attention given to the Green Revolution, and the one in which there are great promises of much more successful attacks on the problems of employment and urbanization, the developing countries of Asia and Latin America spend on agricultural research only about one-tenth to one-fifth of one per cent of agriculture's contribution to their national products. The United States, Israel and Australia, spend proportionately 10 to 30 times as much of the contributions that agriculture makes to their national product. No one familiar with contribution of research and development in the miraculous advances of modern science can fail to see what huge potentials for progress are being neglected by our failures to provide resources for research, pure and applied. In the social sciences, including economics, we are, I believe, even much more delinquent than in the physical sciences, even though economics and the social sciences have grown in recognition and acceptance in all aspects of policy making in the private and governmental sectors of all countries.

Thus far I have said little separately about population growth. But it will already be noted that it runs as a thread through all the problems we have mentioned. The President of the World Bank, as others, has stressed that population planning must have high priority, even in those countries where the symptoms of overpopulation are not yet fully evident. Already we cannot escape the grave impact of past neglect because, as I need not explain to this audience, it simply takes a considerable number of years to achieve sufficient reductions in birth rates to result in reasonable rates of growth. Many governments have shown awareness of the need to act in this field of population planning, but only in a few developing countries does it have a high priority. Even with greatly improved practices and programs, the populations of the developing countries will continue to grow rapidly for several decades reaching 4 or 5 billion, if not more, within 30 years, within the lifetime of the great majority of people in this audience. A total of nearly 10 billion people in the developing world has been conservatively estimated before the world can expect to see a levelling off. It also gives added urgency to the growing concern with the rapid depletion of natural resources such as oil, which has been taking place when the planet has had much fewer people. We cannot escape from this reality of population growth; it will have to be reflected for the rest of this century in the development strategies and policies of the developing

countries, even while hopefully they are intensifying their efforts in population planning.

These are the kind of economic and social conditions which prevail in the developing countries; they are, of course, not complete. I do not state them as my discoveries. They are not novelties. But they have tended to be considered separately and our perspective has matured and improved with more knowledge and practical experience - and I hope they will mature further as we acquire much more knowledge through intensified efforts in research and practical experience from unending grappling with these mammoth problems.

It may be said that I have painted the picture in too gloomy colors. Perhaps so. As I hinted earlier, my ability to be objective may well be affected by my concern and psychological reaction to these conditions. I cannot view, just as many others cannot contemplate, what is happening in the developing countries, the inhuman conditions, congestion, crime, social disturbances - without losing my sense of detachment. As an international official who is at the same time proud of his own national heritage, I cannot view with calm the cynicism, suspicion, hostility and xenophobia which has become so widespread throughout the world. They are not only threatening to our aspirations for progress for humanity, but threaten set-backs of immeasurable magnitude.

These conditions in the developing world combine and interact to make the thin thread which suspends the Sword of Damocles over our various cultures. We need not be falsely pessimistic, just as it is wrong to be unduly optimistic. But we must deal with realities. There is much said and written about the fear that our new science, particularly our new machines for analysis and communications will dominate man. I understand this concern. But, my more immediate concern is that the unwillingness to look at the facts and trends which our sciences are revealing to us is by far the greater danger. People don't like to change time-cherished attitudes or ways of life; they even resent at times suggestions that they should even consider doing so. But it remains our responsibilities as scientists to point out where existing trends are taking us and to help find feasible answers to these very stubborn problems.

However, as scientists in different disciplines we must recognize that there must be a continuous linkage from the university and pure research to daily life. The applied sciences of engineering, agronomy, public and business administration, statistics, etc. and pre-university training of a technical character need not only public support but social acceptance. The engineer must be in actual contact with his employees while the economist must be prepared to do the grubby job of researching out the facts and compiling data. If such practices do not already prevail, changes of this kind will deeply affect the social and personal value systems of a nation and its culture. In this way, I believe, we will maximize the possibilities of preserving those elements of our cherished cultures which are compatible with more successful action

to deal effectively with the economic and social problems of the developing countries. (I could make the same comments on the developed countries).

I will not dwell on the various ways which have been suggested for coping more effectively with these problems, though a number have been alluded to. They merit separate careful and detailed attention. They would encompass family or population planning, resource conservation and utilization, new approaches to modernization of industry and agriculture, central attention to the employment and income distribution effects of such approaches, a sustained attack on the problems of urbanization including new concepts and practices of city planning and formation of new kinds of population centers, a thoughtful review of our consumption habits and their personal as well as societal implications, problems of environment, new initiatives in devising industrial and financial institutions more adapted to national conditions, the integration of such concerns with current fiscal and monetary policies, a re-assessment of ways and means of dealing with external or balance of payments positions and need, usually with greater emphasis on diversification of exports and reduced use of protectionist measures, a new look at how the developing countries can more effectively relate to the higher-income countries, including improved relations in development assistance, and so forth. Much can be done by less developed countries themselves; others are much better done in broader groups; a number involve the behavior of the higher income countries if the problems are to be understood correctly and alternative approaches rationally considered. My own viewpoint assumes that the developed countries will grow economically, that they will avoid severe and prolonged cyclical fluctuations, that they will permit manufactures from the developing countries to have access to their huge markets and that a substantial net flow of capital from the developed to the developing countries will be maintained. I believe that these are realistic assumptions. It is important that the developing countries know what assumptions can realistically be made about the behavior of the developed countries since they fundamentally affect the kind of development strategy which may be regarded as appropriate by a developing country.

Before going further, I would like to make a slight detour to make a point which I believe is worth emphasizing. The recital of conditions in the developing countries is depressing enough even for the most resilient and optimistic person. It may, however, be taken as a recital of failures. I do not mean it to be so. There are many examples of lost or neglected opportunities to do things which were already known and feasible. Population planning is in this category; so is improved fiscal policies and reduced protectionism in the industrial fields. The unfortunate consequences of wrong policies were seen by some, but their advice was, for one reason or another, not heeded. These I regard as "failures". However, some of our present conditions and assessments of them are the result of achieving what was originally intended. Our new views are the consequence of the experience gained

with those successes, i.e. the result of experience - the human equivalent of experimentation. For example, industrialization at the expense of the modernization of agriculture was a deliberate choice made on the basis of what seemed reasonable at the time. We now have many doubts about the wisdom of this relatively one-sided policy, but largely because we know more. I do not regard the successful implementation of past strategies as failures, even if we now, with hindsight, would have adopted different strategies. Perhaps I am over-conscious of this point because of the frequent criticisms heard of the failures of developing countries to achieve greater economic and social progress and stability. More progress and greater stability are desirable and possible, but we must judge results or performance by capability, not by abstract criteria. Albert Einstein taught us to judge results against capability to achieve them, if we were to judge wisely. It is probably too obvious to point out that part of achieving capability is to proceed on the basis of best available knowledge, to re-assess results in light of experience and to modify behavior accordingly.

To return to our main road. Much can be done to cope more effectively with the conditions described briefly today. We cannot judge the true potentials for progress until we have achieved a deeper understanding of the conditions with which we are dealing and a strong persistent political commitment - national and international - to apply our scientific knowledge in a manner best designed to deal with these conditions. Countries like Japan have shown in recent times what national will can accomplish.

Programs to tackle these problems will, however, be confronted by continued dilemmas. The restructuring and reshaping of the developing countries, including its personal and social value systems, will take place in an environment of continued poverty, often in natural resources as well as accumulated wealth and productive capacity and output. There will be chronic scarcities of domestic real resources and the foreign exchange needed to be able to obtain resources from abroad to add to such domestic resources. This reality of chronic scarcity cannot be escaped. It can be helped by policies and activities to improve savings and improve the utilization of such savings, but widespread poverty encompassing billions will be with us for decades. Inflation and balance of payments difficulties will be constant threats. Moreover, the rest of the world will also be feeling scarcities, though, of course, of a very different kind. But the rise in expectations in the higher income countries and the many social problems which require action, like urban decay, environment, educational improvements, racial discrimination and so forth are also very demanding on available resources. The world is not flooded by an excess of savings seeking profitable opportunities, but rather scarcities and bottlenecks everywhere, which may be temporarily blurred by cyclical changes, but do not fundamentally alter the picture. Against this background it needs to be stressed that the

magnitudes of increased assistance to the developed countries being advocated are virtually infinitesimal compared to the output and consumption of the developed countries. We are still speaking of achieving .7 of 1% of GNP for official development assistance. The provision of these magnitudes of assistance would have virtually no effect on the overall ability of the developed countries to deal with their problems of poverty, unemployment, cities, and so forth. Of course, at the margin, all expenditures seem large, but foreign assistance must be seen in terms of the total availabilities and expenditures and their major components.

While we must expect poverty to continue for many years though hopefully declining, the islands of modernity and relative well-being will increase in number and size. This co-existence will continue to make for social tensions and create political difficulties. Statesmanship in private life and government will be greatly needed.

As said earlier, unemployment will continue to be a major problem and a growing one, unless present trends are markedly changed. These trends can probably be changed, if the countries concerned are sufficiently determined to do so. But it will require time, greater understanding of our economies and societies, and international cooperation and collaboration.

The unequal distribution of income we have commented on will be greatly affected by what is done with respect to poverty and employment. There are techniques to achieve major changes in income distribution such as more effective taxation systems designed to favor the poorest while not discouraging overall increases. They are not easy to adopt and implement in practice. Much will depend on the policies of governments, but probably more fundamental are the attitudes of those with higher incomes. Their attitude to taxation can greatly affect the ability of governments to act and the social consequences of such actions. The willingness in industrialized societies of the higher income groups to pay high taxes helps explain the relative social stability in the developed countries during the past generation. Much is said of tax evasion and avoidance - and much goes on - but the effective rates of taxation are virtually unbelievable by standards prevailing before World War II. Earlier fears that high income taxes would lead to the impoverishment of both the individuals taxed and the economies concerned have simply proven to be unfounded.

Again, unless there are marked changes in existing trends, continued and even increasing urban and environmental problems are to be expected. The decay of cities is very costly. It destroys the accumulated wealth of societies already poor, reduces current income, drains off part of their low current income, and deteriorates the quality of life. Here, too, what is done to deal with poverty, employment and distribution of income will greatly affect the character of the problems of the city and the environment. For example, changes

in agricultural and industrial policies which encourage new urban centers to be formed in present agricultural areas, with new kinds of labor - intensive industries and new kinds of financial and fiscal instruments, could make the future urban and environmental problems much more manageable in many countries than those which exist today.

Under these circumstances certain conclusions seem inescapable. Modern developing societies must be seen in the round, not piece by piece. Realities must be faced - the interactions of the parts must be analyzed and understood. Simplistic remedies must be viewed with great suspicion. Short-term policies must be integrated with long-term policies or the continuation of either set of policies is likely to be interrupted. All concerned must have open minds to new suggestions and ideas - which does not mean that the other fellow's mind is now open to your ideas, but, of course, not vice-versa. Commitment to principles, based on value systems helps us to choose priorities and instruments to implement these priorities. This is not, however, the same as stubbornly refusing to review one's attitudes to see whether they reflect the combination of principles and realities which we each try to harmonize in our own ways. I make this point because we have seen, to take historical rather than current examples, how commitments to unrealistic policies based on unrealistic assessments of reality lead to costly disasters in earlier years, for example, in Ghana and Indonesia. The people in these countries now need to use part of their already very low incomes to help repair the damage done. From my experience I would conclude that the persistence of inflation and a distorted price structure indicate that a country is probably not facing up to realities. A recognition that we are dealing with very scarce resources and how to allocate them to best achieve the quality of life valued by the country, combined with institutional arrangements, private and governmental, to ensure these allocations, enhances the possibilities of changing present adverse trends.

In addition to viewing countries as an entity, their international positions and prospects must also be clearly understood and be reflected in the development strategy. Thus, side by side with the evolution of new approaches to domestic problems suited to changing conditions will be need for the evolution of international relations - including trade, foreign investment, international development assistance and so forth. These relations cannot remain static, conforming to conditions which no longer exist. The new thinking on the problems of the developing countries and how they might better be tackled is likely to influence greatly those international relations in the future. For example, more assistance may be given for projects which are employment creating or improve the income of the poorest groups or which ameliorate urban conditions. In the international field, as in the domestic economic and social fields, what is needed are policies which give a very high priority to overcoming the conditions we have been describing.

I have become increasingly persuaded that to achieve changes in existing adverse trends and to strengthen existing favorable trends, countries must try to succeed in doing the following:

(1) Agree on a commonly accepted national value system. It should be sufficiently simple to be commonly understood and accepted. It must make those activities which help deal directly with the ills of society socially prized and not merely acceptable. It must encompass what are regarded as the basic problems and establish an order of priority for meeting existing social and economic needs. It must provide a basis for judging what are the acceptable political and social means of applying this value system. The value system must rest solidly on the needs and culture of a particular society.

(2) Base the national value system on individual value systems. No national system can or need have unanimous support, but individual conduct cannot be too different from the national norms. What the individual respects, the nation will respect. Moreover, national systems so based will have a better chance to avoid the danger of too frequent changes in major policies and activities which result in waste and confusion. Nature is wasteful, but man cannot afford to be, once he recognizes the universality of scarcity of resources compared to needs, and yet wishes to improve the human condition.

(3) Find ways and means to articulate these value systems in a material development strategy so that national priorities are chosen and are implemented in practice. The development strategy reflected in national programs and policies including education and research must be based on detailed knowledge of the entire economy and society. It must not be constructed in piece-meal fashion. What is done in individual sectors must recognize the interactions among various sectors of an economy usually acting through the market mechanism. The necessary knowledge must be acquired from first-hand experience. The national policy-maker must be prepared to sit down with those in the local communities to obtain a realistic picture of what are the actual problems and alternatives to be sure that his criteria are correct and that policy decisions are well chosen. Moreover, implementation must not be divorced from formulation of policies. The most elegant formulations are worth little if they are not realistic, even though they are internally and logically consistent, or if they are not implemented in practice. Implementation means continuous and constant contact between policy-maker, scientist, engineer, technician and worker on the job.

(4) Find ways and means to protect and shield economic and social development programs from political and social tensions and disturbances. In effect, political issues should be about values, priorities and appropriateness of alternative mechanisms, e.g. different kinds of tax systems. Once agreed, and formulated in programs, the implementing decisions should be regarded as technical, rather than political.

Programs will require changes because of the dynamics of change. But the changes made should aim always to protect the progress already made. In effect, much that is now regarded as being in the political arena would be regarded as technical, that is as outside the political arena. The physical sciences have shown how far societies can go in this direction and already in certain aspects of the development fields as, for example, in the attitude towards already undertaken public works, this viewpoint exists. Even hostile forces have respected public works built with international support.

I know that this will sound like a council of perfection to many -- idealistic and unreal -- even romantic. They seem to ignore the world of reality. However, our generation has already achieved many things which a generation ago would have been regarded as unreal and romantic. I cite some:

1) Elimination of political domination of large areas of the world by others.

2) Recognition that nuclear wars must not be allowed to take place.

3) Ending the acceptance in industrialized countries of large scale unemployment and prolonged and severe depression.

4) Great progress in reducing poverty.

5) Greater acceptance of concepts of personal equality and implementation of this concept in countries where personal inequalities for racial and other reasons have long existed.

6) Acceptance of the concept of universal education.

7) Recognition of need to end ruthless wastage of natural resources.

8) Ending of individual and cultural isolation, what may be summarized as the transformation of man into mankind.

9) The formation of a "global" brain through the internationalization of science, knowledge, and technology. "The new man" has the use of great instruments of acquisition and communication of knowledge, while at the same time is in immediate and continuing relations with all other men. This results in fantastic multiplication of ability to cope with human problems. We have many examples of "demonstration" effects of failures and defeats but even more examples of "demonstration" effects, less publicized, of sharing of new inspirations and aspirations as in medicine, psychology, education and productive technologies.

10) Perhaps most important is the general acceptance of the need for change. Complacency or indifference has been replaced by impatience and concern.

Permit me to conclude by saying that I do not regard myself as optimist or pessimist. I like to think of myself as scientific in the modern sense of combining the standards, methodology and motivation of science with a value system appropriate to modern conditions. Perhaps, I am overly concerned with adverse trends, but in the past, the stakes were always partial, with only a small part of human race involved; now the stakes are world-wide. This reality is now being recognized and when the need is translated into action, the resulting willingness to use our present technology to realize existing potentials plus the impact of innovations still to come may well make past progress seem slow and small.

As for the scientist's role in this process of transforming human beings into humanity, the starting point for me is, as I have said before, the recognition that our role is not merely to analyze present trends and foresee where these trends are taking us, but also to change them when we find them unacceptable. This means linking science not only with the problems of living, but also with the necessary daily activities to cope with these problems. In this grand assignment, all of science will continue to be critical for the progress made.

Scientists will continue to help us to identify the real obstacles and to find the solutions. In so doing, they are in the great tradition of science which has repeatedly refused to accept the obvious and, in so refusing, made the impossible become the obvious.

Thank you.

Irving S. Friedman
December 14, 1971
Colombo, Ceylon

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Paper prepared for the Eighth
Conference of the Governors of
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Balance of Payments Management and Implications for International Monetary Reform— a Developmental Approach

I wish to express my appreciation for the honour of addressing this Conference of Governors of Central Banks of South-East Asian countries. I am well aware of the wealth of experience and knowledge represented by those in this room today.

I have chosen to speak on a subject which is a continuing major concern to any central banking authority, namely balance of payments management. Since your subject for discussion on your agenda this year was international monetary reform, I will make certain remarks on the implications of balance of payments management for this subject. Much of my remarks will focus on the role of central banks in the development process. It is with these preoccupations in mind that I would like to make some generalizations about balance of payments management, particularly in developing countries, bringing to it what may be called a developmental approach.

There are always dangers in generalizations about developing countries, when economic diversity rather than homogeneity is to be so widely found. Even among the countries of South-East Asia major domestic and external differences in conditions, behaviour and policies are to be found. However, there is usefulness in making generalizations from cross-country comparisons as long as they are recognized as such and not taken to depict any one particular country.

Experience to Date

With few exceptions most developing countries have repeated, if not, chronic difficulties in balance of payments management. Certain countries with extraordinary circumstances like substantial oil production, large foreign exchange expenditures for military purposes and large net

sustained inflows of private or public capital may be able to avoid these difficulties in external management, at least for some years. Indeed, as we now see, as scarcities develop in certain food commodities like rice, sugar and meat products, countries which have long experienced balance of payments difficulties may experience rather long periods of relative ease because the relative scarcity of their principal exports may well prove persistent. (Indeed, one of the areas requiring close observation these days is the trend in primary product prices as we may be witnessing some fundamental changes in terms of trade for certain commodities and countries).

The explanation of why developing countries have had chronic balance of payments difficulties has been elaborated in many different places. Concepts like the savings-investment gaps and foreign exchange gaps are familiar and need no explanation here. Also familiar are the usual conditions of low monetary reserves; the inadequate and uncertain character of private and public capital inflows; the lack of symmetry between the terms on which external capital is obtained and the balance of payments outlook; the increase in external debt, often to onerous levels; the administrative difficulties in formulating and implementing foreign exchange budgets and tariffs, or their substitutes. Certain factors, however, may be worth noting because they are less familiar and accepted.

Balance of payments difficulties are not the result of poor national resource endowment, low levels of productive capacity or income. Countries which accept such conditions and adjust their economic and social behaviour to existing national and international trends need not have chronic balance of payments difficulties. Temporary and sporadic difficulties due to droughts, cyclical developments abroad, and domestic monetary disturbances will occur but they are essentially self-corrective or reversible. Use of available reserves and/or international facilities like the IMF can cope with them.

The chronic aspect of balance of payments difficulties in low income countries results from the need and desire to change existing conditions and trends by governmental policies, usually in the direction of accelerating the process of economic and social change to achieve more rapid improvements in material well-being and the more equitable sharing in this

improvement than would result from a passive governmental role in the economic and social life of the country. Governments decide to push ahead, despite institutional weaknesses or hardships like inadequate public administration or a relatively small entrepreneurial group. Institutional innovations and adaptations do not precede the acceptance of new responsibilities, but instead take place simultaneously or after failures. The market mechanism and incentives may still be the principal means of ordering economic and social behaviour, but within an environment greatly influenced by government policies.

This process of acceleration means pushing total demand for consumption and investment, private and public, to levels which exhaust availabilities from domestic and external sources. It means continuous straining of capacity, creation of bottlenecks and friction, like increasing urban unemployment. It manifests itself in most cases in persistent inflation, whether seen in rises in prices and costs, or externally, in repeated balance of payments crises. In the developing countries, under-utilization of productive capacity which occurs frequently is not usually due to lack of overall general demand. It is rather due to special factors like foreign exchange shortages keeping needed imported inputs below requirements. Industrial capacity in particular industries is artificially swollen by import-substitution policies, inflation and the maintenance of an overvalued currency to a level beyond the absorptive capacity of the home market while the products are too costly to be competitive internationally. Also fundamental structural transformations like modernization of agriculture, improved governmental administration and educational reform take time to absorb.

Chronic balance of payments difficulties are not the consequence of slow growth rates per capita. Indeed, rapid growth rates may be accompanied by external difficulties. This is a vital point because often the choice seems to be between rapid growth and avoidance of chronic balance of payments difficulties. Actually the true choices are among the kinds of growth that are desired and how they are achieved, rather than between growth and balance of payments difficulties. Historical experience tends to indicate that growth rates above 7 or 8 per cent are accompanied by balance of payments difficulties, but this is not conclusive that any causal relationship necessarily exists.

Closely related to governmental acceptance of responsibility for accelerating economic changes is the acceptance of other even broader social responsibilities, like the elimination of sub-minimal nutrition standards, protecting environment and conserving natural resources. Family planning is a key aspect of this sense of responsibility since rapid population growth is an important common factor in making all of these objectives more difficult to attain.

The promises and commitments which governments have made not only to change existing trends, but to do so in specified ways and within specified time limits, creates conditions which make the avoidance of repeated disruptive balance of payments crises very difficult, if not impossible.

The reasons why modern governments promise more than they can deliver are great in number and warrant separate treatment. Perhaps, it is enough herein to point to the fact that the current definitions of the responsibilities of governments are relatively recent in origin. Developing countries do not have long experience on which to draw and are often inspired by thinking and experience in the developed countries. Countries are learning what is possible and what is not by the hard road of actual experience, including repeated failures.

For balance of payments management it is particularly important that the consequences of these conditions are often, as just noted, persistent inflation and inflationary expectations. This means diminished domestic savings, particularly in financial forms most usable in achieving productive investment in agriculture, as well as in industry, social overhead capital and other sectors. It also means capital flight and other forms of high cost or unproductive investments. Given inflationary expectations, monetary and fiscal policies do not achieve their purposes and income distribution become more inequitable. Because inflation hurts most of the people in a country and benefits only the few who can successfully defend themselves and profit in an inflationary environment, balance of payments managers are caught in a situation of heightened political and social tensions, as well as economic difficulties.

The very definition of appropriate external conditions is altered by the inflation. Is the external sector to be made to conform to the domestic inflation by repeated exchange rate devaluations which help to maintain export earnings while diminishing import demand by increasing the local prices of imports? Or, is the external sector to be made to reduce the domestic inflation by encouraging more imports while reducing exports, or is the external sector to try (in vain) to pursue the developmental objectives which are being disrupted by the domestic inflation? Inflation is well recognized as a cause of balance of payments difficulties; what is not always as clearly seen is that persistent inflation creates conditions which both disrupt development and make successful balance of payments management by developmental criteria virtually impossible.

Another aspect of the chronic balance of payments difficulties which may be worth stressing is, like inflation, rather familiar, but not always sufficiently taken into account. This is the political fact that governments often do not give the highest priorities to the pursuit of policies to achieve their own announced developmental objectives. Often, short-run considerations of political expediency, or other non-developmental objectives or criteria, mean surrendering developmental objectives. More fundamental, perhaps, is that in many countries the people therein have not yet made the decision that social and economic development is their highest priority. The political processes must therefore be devised to enable policies to be pursued over a long period of years in a manner which is acceptable to the people in the country. Public policy must be based on public participation and consensus if it is to endure, though the method of achieving and expressing this consensus may well differ among countries.

One more aspect of the chronic balance of payments difficulties of developing countries may be mentioned, namely the international vulnerability of such countries and their weak international bargaining power. Unless in extraordinarily favourable positions, like suppliers of fuel or industrial raw materials or foodstuffs in short supply, developing countries tend to be unable to protect themselves from serious hurt by adverse changes in conditions abroad. The literature on commodity behaviour and international agreements is very rich with examples of this problem. A country depending on one or two primary products for the bulk of its export earnings cannot shift readily from one export to another in response to changes abroad.

The process is often time-consuming and painful, and frequently wasteful, as further changes in external conditions make the domestic adaptations obsolete. Moreover, developing countries cannot usually hope to defend themselves against policies taken by other countries which are harmful to them. The threat of retaliation is not sufficient protection against large economic units because they are often able to be indifferent to such retaliation. This international vulnerability and inadequate defenses may make for repeated and major difficulties even for low income countries which are managing their economies satisfactorily.

Effects of Chronic Balance of Payments Difficulties

Just as the causes of balance of payments difficulties have been frequently analyzed, so have their effects. These effects are often analyzed in terms of loss of monetary reserves, need to borrow internationally, and difficulties in meeting international payments. All too familiar are the repeated need for stabilization programs, including exchange rate changes, the recourse to external assistance, the use of floating exchange rates, multiple currency practices, exchange restrictions, quantitative restrictions for balance of payments purposes, the external debt problem and so forth. Again, what may still merit stressing is that these chronic balance of payments difficulties upset development. Too often these difficulties are accepted as the inevitable price of development- a cost to be incurred if the benefits are to be reaped. The external difficulties may be the consequence of pursuing developmental objectives, but only in the sense of purpose dominating government activities. Even when this is true, the external difficulties are the consequence of the use of wrong policies to pursue developmental objectives. The difficulties which are consequent to these wrong policies retard, if not disrupt, the development process. This distinction is of key importance. Desirable and feasible development objectives may be attacked and abandoned when the proper targets of criticism are the wrong policies.

Distinctions among Causes of Balance of Payments Difficulties

Implicit in what has already been said, is that there are significant distinctions among the causes of balance of payments difficulties of developing countries which are important in considering policy-making or balance of payments management.

(1) There are the balance of payments difficulties generated by domestic conditions inherent in the development process of a low income country trying to accelerate social and economic improvement.

(2) Balance of payments difficulties generated by external factors or factors beyond the control of governments and their people.

(3) Difficulties generated by human error—distinctly different from mismanagement because it is the consequence of a lack of understanding of economic and social behaviour because of unavailability of adequate knowledge or the non-suitability of known analytical techniques. This concept of human error does not include accepting development objectives which analysis indicates cannot be achieved even with feasible changes in policies and institutions. This kind of error is an example of mismanagement.

(4) Difficulties generated by domestic economic and social mismanagement. In these cases the economic and social consequences of policy measures are often predictable, including consequences which are harmful to the development process as well as causing balance of payments difficulties. In such cases there is inadequate political will or ability to avoid the difficulties. Objectives are defined which cannot be achieved, or, if achievable, the needed changes in policies and institutions are not made. Examples of such are myriad—lack of incentives to encourage savings; ignoring the distributional aspects of development programs, creation of environments which discourage productive investments; neglect to build new institutions or adapt existing ones; unrealistic development planning; reliance on administrative controls which are known to be weak, and so forth.

(5) Another category of causes of balance of payments difficulties is closely related to the previous one but different enough to warrant distinct treatment, namely difficulties generated by poor balance of payments management. The examples in this category are not as numerous as in the broader category of domestic management, but they are still very many. They include failure to project the likely consequences for balance of payments behaviour of decisions in all major economic and social fields including housing, urban improvement, environment or employment creation; use of unrealistic exchange rates, or more subtle, the use of exchange rate changes to offset differentials between domestic and external rates of inflation without accompanying such exchange rate adjustments with policies

designed to bring about desired changes in consumption and investment; recourse to multiple currency practices which distort investments and income distribution; use of exchange or trade controls to suppress inflationary demands for imports; poor monetary reserve management which does not carefully weigh the longer-term costs, benefits and risks of maintaining various alternative levels of monetary reserves or alternative forms of monetary reserves; incautious external debt management, including lack of sufficient thought to the kinds of external capital required and ensuring their efficient use; unrealistic assessments of behavioural responses in balance of payments, e.g., capital flight and smuggling, to various balance of payments measures like use of exchange restrictions, etc.

Lessons to be Learned from Experience

These distinctions are hopefully useful for policy making because they enable us to learn more from experience. The most important single lesson is that successful *domestic* economic and social management is the prerequisite for successful balance of payments management when judged by developmental criteria. A corollary to this is that developmental criteria are the appropriate ones to use for a developing country. If developing countries are unsuccessful by development criteria, the reasons for failure may be eminently understandable and, in this sense reasonable, but they are failures nonetheless. Measures can be taken such as floating exchange rates and exchange restrictions or temporary credit restraints which avoid or overcome balance of payments crises in the short-run or even for some years. But unless progress is made in breaking the bottlenecks including the institutional restraints which impede progress towards achieving the objectives of social and economic development, the low income country is not being well managed. The avoidance or overcoming of balance of payments crises may be helpful, and can be very helpful, if done in such fashion as to help achieve developmental aims. Otherwise, the avoidance or overcoming of balance of payments crises may paradoxically even be injurious in the longer run. The stabilizing measures may raise expectations which then prove false because if the underlying developmental problems remain unsolved the crises will recur. Confidence will then be further weakened and increased uncertainties will again reduce savings and result in a pattern of investment, consumption, employment and income distribution far removed from the desired developmental objectives.

Thus key questions in balance of payments management are what are the economic and social objectives of the developing country concerned; what is the ordering of the national priorities; what can realistically be achieved in a given time span; is the temporal sequence in the ordering of priorities and selection of policies sensible; how can an environment, political and social as well as economic, be created which is likely to lead to success? Are the public and private institutions capable of carrying out the needed changes?

The international monetary system is the set of international rules which govern the balance of payments management of individual countries - what is internationally permissible and what is not. To look at the balance of payments management of a developing country from the developmental viewpoint means that the international monetary system must enable a low income country to pursue developmental objectives and to be judged by developmental criteria in the acceptability of its behaviour and the worthiness of its case for international support.

In these ways we begin to look at balance of payments management and the international monetary system from the viewpoint of development. By starting with the development process, we can ask ourselves how the balance of payments can be managed to best defend the development process and what kind of international monetary system is best designed to achieve the national objectives which we summarize as social and economic development.

I will not dwell on the choice of national objectives. Countries differ in the relative weights attached to per capita growth, modernization of agriculture and industry, the reduction of increasing unemployment and under-employment, income distribution generally, or more specifically, the avoidance of large scale poverty or untaxed great wealth, social and political stability, international dependence or independence, preservation of traditional customs and institutions, like the joint family, willingness to accept "foreign" practices, attitudes on private ownership of capital - often distinguishing between "national" and "foreign" ownership, desire to change existing patterns of holdings of wealth, eagerness to protect their physical and human environment, provision of adequate health and education, and so forth. Countries will determine these priorities for themselves. For many years they were largely swayed by fads and fashions coming from abroad with

their ever changing emphasis on different aspects, but the responsibility of accepting these fads and fashions remains with the countries.

There is increasing evidence of more careful selectivity of national priorities based on national conditions rather than superficial imitation of others or over-simplified applications of ideas based on the experience of others. There is, however, the danger that this trend may go too far and the experience of others not carefully studied for what is relevant instead of insistence on learning only by the costly method of experimentation.

There are certain ways by which every country can choose among its national objectives and possible implementing measures in a manner which increases the likelihood of success. Of prime importance are the ways and means of testing the feasibility and probable consequences of these national objectives and, more particularly, of the policy alternatives which are being considered to be used to achieve these objectives. The failure to subject development strategies and policies to tests of feasibility is to run the grave risk of serious failure in achieving development objectives.

Fortunately we do have the techniques which can be used. I would like to concentrate particularly on financial programming, credit budgets and the use of flow of funds and savings analyses as ways of testing a development strategy and its implementation. Many developing countries find it useful to formulate development strategy embodied in a development program or plan covering a span of years, usually limited to five or six years. Objectives or targets are set and basic priorities for government action are chosen. By stating objectives or "targets", and setting priorities, there is hopefully more chance of having policy measures which achieve these objectives. It is well recognized that to plan a program will require continuous re-examination and modification over time. The political bases may change and the economic assumptions may well prove not to be correct, particularly the behaviourial reactions of the consumer and the producers to the policy measures adopted by the government. In all fairness to makers of such plans, which are frequently criticized for not being realistic and not being achieved in practice, the underlying political and economic assumptions are often foreseen to be highly tentative and even questionable. They are a combination of best judgments or compromises on assumptions, inevitably conditioned by

wishful thinking or deeply felt personal and political biases. Moreover, there are many factors importantly affecting the implementation of the plan which are known to be unknowable, such as weather conditions affecting production in the agricultural sector, or factors which depend on developments abroad and determine such important magnitudes as the levels of foreign exchange earnings, and aid and the terms of trade.

Planners are also well aware that their long-run thinking can only be implemented by short-run decisions. The ideal implementation has been well summarized as follows: "The long view avoids the danger of aimless wandering, while, short-run decisions, by modifying the plan as circumstances warrant, make the basic objectives more attainable."[1]

A key link between the plan and governmental policy is the annual budget making. The budget gets a great deal of attention in countries, particularly the major figures on expenditures and receipts. However, attention to fiscal policy is not enough in a developing economy—it is probably safe to say that it is not enough in any economy. The financial implications of other operations in the public sector, investments and subsidies, as well as activities in the private sector must also be analyzed, understood and faced up to by the public authorities. There is no use making believe that the budget tells us all we need to know. The budget simply covers too small a portion of the total economy to be sufficient in itself for assessing and achieving developmental objectives. There is need for the use of a broader concept and technique, namely financial programming which attempts to ensure that the total supply of financial resources of the entire economy keeps up with the total demand on these resources. A financial program can be used to test the feasibility of investment plans and other government expenditures. It can help determine whether and how the projected governmental expenditures, including investments, can be financed.

Financial programming consists of estimating the total supply of financial resources and the total demand. The former includes government revenues, private savings usually held mainly in the form of deposits with the banking system, and loans and credits from abroad. Among the sources of demand are government current expenditures, investment plans of the private and

1/ Mookerjee, Subimal, "Financial Stability and Planning", **Finance and Development**, March 1972, p. 7.

public sectors, and foreign debt repayment. Financial programming tries to make estimates of these various sources of demand and supply in the form of projections through the banking system. In this way, among other benefits, the overall financial position of the public sector vis-a-vis the banking system will be much more clearly seen than by analyzing the budget with its traditional accounts resulting from past preoccupation with the simple question of how much the government will spend and how will it be financed.

In this way a judgement can be made whether the demand for financial resources is likely to be balanced by available supply from domestic and external sources. The role of the anticipated balance of payments deficit becomes obvious. Then the question can be intelligently addressed whether this deficit can be financed by use of reserves, or external financing, e.g., inflows of capital on acceptable terms. In this connection, the authorities have to come to clear-cut decisions on certain key issues like appropriate levels for foreign exchange reserves and magnitude of external capital likely to be available on acceptable terms. If the analysis and decisions made lead to the conclusion that the deficit will be too large because of excessive draft on foreign exchange reserves or inability to obtain the required magnitude of external financing on appropriate terms, the authorities are confronted by the clear necessity to modifiy their policies and/or their objectives. It may not necessarliy mean a reduction in government expenditures; it may mean changes in polices to induce more savings or increase tax revenues, which, in turn, must be subjected to tests of feasibility. It may mean a reduction in private expenditures—consumption or investment. The consequences for the entire economy must be carefully scrutinized to ensure that the reduction of private expenditures will not be more damaging to the development effort than the equivalent reduction in governmental expenditures as well as vice versa.

The allocation of resources between the public and private sector which results from the combination of fiscal and credit policies should be made by developmental criteria, e. g., growth, employment and income distribution, and not by short-run criteria, e. g., immediate political expediency. There is no avoidance of the risks involved in choosing among alternative policies. Policy makers must be prepared to deal with the unexpected or less likely becoming the reality. This is very different, however, from not knowing the risks or not trying to weigh carefully the implications of alternatives from a developmental viewpoint. A willingness to adopt policies

and make institutional changes, if needed, can go a long way in offsetting the uncertainties of financial programming. If, as a matter of fact, the ability to make changes does not exist, or can only take place over a much longer time period than is required to make the program work, then alternatives involving a high degree of probability that such will occur need to be ruled out in advance. Self-deception is the easy way out of making difficult choices; financial programming makes self-deception more difficult.

Financial programming is often done as the result of relations between the IMF and its members. It is urged that financial programming not be done only in cases of balance of payments crises and thus be taken as a sign of such crises, but, instead, that it be a regular feature of government poilcy making, done annually along with the fiscal budget. The public as well as government authorities should expect the financial programs to be done on a regular basis. They should subject them to at least the same degree of scrutiny as the fiscal budget and examine each in the light of the other.

Closely related are what might be called credit budgets. These can be part of a financial program, but more detailed. The major sector of an economy can be broken down- e. g. households and non-corporate entities, public non-financial corporations, governments at different levels, financial institutions, private and public, even major productive sub-sectors of industry, agriculture, domestic trade and international trade, etc, to see more precisely the sources of demand for credit and how it is expected to be provided. Then the working of the overall development program will become vivid. Financial data are often more available and accurate than other data, which helps in this exercise. A detailed credit budget will help make clear whether credit is going where it is needed to achieve developmental objectives The opportunity cost of credit allocation techniques and their consequences—whether done by interest rates and reserve requirements, or administratively—will be evident. This analysis may be too technical for discussion by publics in your countries—I would hope not—but at least it can be prepared annually along with the fiscal budget and financial program for the use of government *before* policy alternatives are chosen and implemented. Again, this suggestion leans heavily on the experience of the Fund, particularly in their stabilization programs, where the use of credit ceilings as a performance criterion has provided a reasonable assurance of the intended balance of payments outcome. The suggestion made herein calls for more

detailed analysis, to the extent that the data (and feasible creation of new data) permits and, probably more important, a shift in emphasis in relating the intended balance of payments outcome to the intended developmental outcome. It is this shift in emphasis which justifies the work on more detailed analysis since overall credit ceilings or subceilings for very broad categories like the public sector taken together may well be sufficient for achieving the desired balance of payments outcome, but not be sufficiently helpful as a test of the viability of a social and economic program by developmental criteria.

Thus credit budgeting as herein defined would deal closely with the distributional aspects of credit which are not the concern of financial programming except in the broadest sense, e. g., the public sector vis-a-vis the private sector. Distributional aspects are very important for development. It is not enough to balance overall demand and supply for savings and financing. It is also necessary to ensure that the use made of savings help bring about the desired developmental changes. For example, from a developmental point of view it is not only important to know whether adequate credit will be available for the agricultural sector versus, say, the industrial sector. It may also be important to know whether credit will be available on reasonable terms to small farmers to purchase fertilizers or to farm cooperatives to purchase tractors; similarly, it is important to know whether too much credit is being given for some activities in the light of development priorities. This selectivity is still within the framework of the desired price and balance of payments behaviour, but again the shift in emphasis means major changes in policies and institutions to achieve the desired selectivity. The more detailed comprehension also helps in cutting back demand when it is evident that total demand cannot be satisfied without disruptive price and balance of payments effects. Cutbacks can then be chosen which will avoid or minimize the damage to the development process. Thus credit budgeting can be an instrument of testing both overall and distributional feasibility.

Another way, and complementary to financial programming and credit budgeting, of testing policy measures or objectives by looking in sufficient detail at the availability and distribution of savings is by the use of flow-of-funds analysis. Flow-of-funds and savings analysis is now done, for example, in Australia, Germany, Japan, the United Kingdom and the United States. Savings and flow-of-funds analyses essentially use national

income and product accounts. It tries to identify the sources of gross savings, in all forms including physical assets of households. It divides the economy into major sectors and sets up a matrix of savings and financial flows — identifying the sectors which are the sources of savings and financial flows and the recipients of such flows. The division into sectors and subsectors differs among countries reflecting the differences in their institutional arrangements as well as the structures of their economies. The major contribution comes from including all savings and investments, not merely financial. Thus, in dual economies with large non-monetized sectors a savings and flow-of-funds analysis can be an important supplement to financial programming and credit budgets.

The savings and flow-of-funds analysis subjects any plan to a rigorous scrutiny as to its financial feasibility. Instead of assuming that total investment has merely to be in line with total savings and that the investment pattern can be based on physical aspects like production capacities, and input and capital coefficients, it recognizes that the investment pattern is also a function of the structure of savings.[1] Failure to appreciate this leads to inflationary pressures and domestic and external imbalances. This approach recognizes that the planned pattern of investment has to be consistent with the evolving structure of savings. Thus it can greatly help to determine the overall as well as sector-wise composition of investment and achieve the desired investment pattern by having an adequate analysis of the structure of saving and the flow-of-funds in the base year and the likely changes in this structure during the plan period as a result of changes in fiscal and other policies affecting the structure of financial institutions, instruments, interest rates and overall saving. It is not feasible nor necessary to go into details on the technique of financial planning based on savings and flow-of-funds analysis. It has been the subject of considerable literature.[2] It may be useful to point out, however, that what is being sought is a complete picture of changes in the financial assets and liabilities including

1 See Dr. V. V. Bhatt, "Saving and Flow-of-Funds Analysis: A Tool for Financial Planning", paper presented at the Biennial Meeting of the International Association for Research in Income and Wealth, 1969, and reproduced in **Reserve Bank of India Bulletin,** September 1969.

2 For example, Raymond W. Goldsmith, **The Determinants of Financial Structure,** OECD, 1966.

those outside of the banking. In this sense it goes beyond the banking system. Secondly, it includes the non-monetary sector, particularly households; *inter alia*, this makes clear how more savings in financial form might be generated and thus become usable by the entire economy. Thirdly, personal and business savings are functional relations which do not change rapidly. Therefore, though complete current data may not be available, estimations from partial current data can be made. Fourthly, the data used are financial data such as government accounts, the accounts of banks and insurance companies and other corporate entities. These are relatively good sources of data. Finally, this technique by clearly identifying external capital in relation to different sectors makes much more explicit how inflows of net foreign capital are being used and whether they are serving the desired development objectives.

The centrepiece is the lending role of the household sector. After payments of taxes and dividends, the private sector cannot be expected to self-finance its investments, including inventories. The government—the public sector taken as a whole—is also a net user of household savings Private investment and public investment depend on household savings, but the degree of dependency can be changed as well as the magnitude of lending which the household sector can do.

This type of analysis helps answer the question whether a set of governmental policies is likely to generate enough savings to meet total demands. It can do this by reducing the net calls on household savings by the private sector (e. g., lowering taxes), or by the government (e. g., reducing government expenditures) or by increasing savings by the households particularly in financial forms. By placing the household sector in the centre of the stage, policy measures are encouraged which increase savings and ensure better usage of savings. It makes clear that in the ultimate, other sector expenditures are only made possible by restraining general consumption relative to what it would otherwise be. If the public were clearly aware of this phenomenon, their interest in policies allocating savings among different expenditures might well be greatly increased. It also makes clear how important are the resources provided by the external sector.

It may be said that such techniques are too advanced for developing countries. On the contrary, they may well be more efficiently used in the

less complex economies of developing countries. The data needed for such savings and flow-of-funds analysis should be at least as easy to obtain as national income data.

Through the use of the savings and flow-of-funds analysis it is possible to get an approximate judgment of whether net capital formation of each sector is consistent with the pattern of savings and flow-of-funds. If the desired sector-wise composition of investment is not consistent, it then becomes evident that policy measures are needed to change the savings pattern of the household sector and the lending pattern of the financial institutions. This could include measures to insure that the net capital inflows are being used for intended purposes. If such policy measures are not feasible, the desired sector-wise pattern of investment would have to be changed. Thus, the investment decisions which make up the implementation of the national development strategy can be made much more realistically, increasing the likelihood of successful achievement of development objectives. In this manner, the shortcomings of a financial program which does not show intersectoral relations within the economy or the significance for sectors of the expected balance of payments position could be largely overcome. These intersectoral relationships are critical for the development process. Moreover, in this manner policy issues like choices among competing priorities and the likelihood of suggested policy changes being successful in achieving their aims are brought into sharp focus.

The use of financial programming, detailed credit budgets and savings and flow-of-funds analysis, among other things, underlines the importance of financial institutions in the development process and the key importance of the central bank. As noted earlier, all financial institutions, including purely commercial banks, are development agencies in a developing country and the central bank is a key, if not the key, developmental institution. It does not flow from their legal charters, but from conditions in their countries and the decisions of nations to accelerate the development process by governmental measures. All institutions, private and public, then become the implementing agencies. The most all-pervasive institutions are the financial ones, and the manager or supervisor of these institutions from the national viewpoint is the central bank. It is for this reason that I believe that the central bank should consider taking on he functions on a regular basis of preparing financial programs, detailed credit programs and savings and flow-of-funds analysis with, of course,

the collaboration of other private and public institutions. This would enable the central bank to fulfill more effectively its responsibilities to the government for domestic and external monetary management. In any case in a developing country, unless the developmental objectives are realistic and being achieved, domestic monetary stability and satisfactory balance of payments behaviour will not be achieved. The central bank can be given the responsibility for assessing the feasibility of development strategies and policies. The central bank would build on its tradition of technical excellence, objectivity and avoidance of political partisanship. Governments, which would have to give this role to central banks in the first place, would still retain their ultimate authority and central banks would be expected to do their best to implement the political decisions once taken. But the central bank would now have a clearly recognized major role in the development process; its responsibilities as advisor to government would be explicitly broadened. There are central banks in developing countries, e. g., Brazil and India, that have already gone a long way in this direction, but much more could be done in many more countries. The degree of confidentiality or publicity given to the work done would depend on countries and their governments.

Another function which would then emerge for central banks is the initiation of innovation in the financial systems of their countries. This might take the form, for example, of more extensive geographic use of existing financial institutions, or inventing new financial instruments, e. g., additional credit instruments acceptable for rediscounting with the central bank or savings instruments exempt from income taxes, or suggesting new functions for existing institutions, or suggesting new institutions, e. g., special banks for export financing of new products and credit agencies for small producers. Other agencies as well as individuals will also continue to be sources of such innovative suggestions, but now a criterion of success of a central bank would be its ability to suggest, advocate and, if necessary, help bring into existence other financial instruments and institutions and whether these innovations proved successful in practice. Capital markets come quickly to mind for some developing countries, but the opportunities for useful and successful innovation are great in all sectors and subsectors of the economy.

This would mean that many central banks would have to extend their area of technical competency to include fiscal measures on a detailed level

as well as more intimate knowledge of the real economy. Their staffs would have to have the kind of knowledge that is reflected in input-output analysis which articulate the functional relations within the productive and distribution mechanism of any economy. The central bank staff need not prepare such analysis of the real economy, if others can do so, but would have to be able to judge what was being prepared and link its own analyses to the others. Similarly, it would have to be able to handle such questions as the feasibility of specific policy measures as they affect the economy domestically and internationally. Inevitably this will result in suggestions for changes in policies emanating from the central bank going well beyond changes in money supply, credit, or overall balance of payments behaviour and management.

It is appreciated that this means involvement in the political decision-making process. But the central bank is already deeply involved in the political process in fulfilling its more narrowly defined existing functions. It means to be involved with the hope of being more useful and effective in helping to achieve developmental objectives. The involvement in the political process is *not* the same as political partisanship or public disagreement with government policies. Central banks are part of government. The suggestion is to strengthen their autonomy and breadth of responsibility to fulfill their potential as contributors to the development process. Any evolution along these lines depends, of course, on governments seeing the urgent need for testing and foreseeing the domestic and international consequences of alternative domestic and balance of payments policy measures. With this approach, the role of the central bank in balance of payments management begins to reflect more fully what is involved in balance of payments management when seen from a developmental viewpoint.

The use of these improved tools of domestic management also automatically helps improve balance of payments management. They help distinguish between balance of payments deficits which are part of the development program and deficits which reflect difficulties and result in "crises". From a developmental viewpoint it is not enough to judge balance of payments performance by changes in monetary reserves or short - term foreign assets or even the need to use restrictions on payments. Balance of payments performance should assist implementation of a successful development program. Therefore, the objectives or purposes of the development effort must also

be met—purposes and objectives which have now been submitted in advance to tests of feasibility. If these purposes are not reasonably met, governments too often find it necessary to take extraordinary measures, like large increases in governmental expenditures to meet social pressures from particular groups, or credit expansion, which upset the development program, strengthen inflationary pressures, create balance of payments difficulties and cause consequent retrenchment at the expense of the development effort.

As in the case of domestic management, balance of payments management should be part of a long-term strategy which fits into the long-term development strategy, but implemented in a flexible manner on a day to day basis. The use of developmental criteria, as indicated, would result in a much greater interest in the behaviour of all of the items in the balance of payments. Changes in different items in the balance of payments—current as well as capital — can be used as indicators or early warning systems as to whether the objectives of the development programs are being achieved. If they are not, this may indicate a need for a comprehensive review of the development program or changes in specific policies or institutions. If farmers are not importing needed inputs and farm productivity is suffering, the development program is not succeeding, even if the balance of payments overall is manageable. The answer to this developmental kind of balance of payments difficulty may be found in changes in the savings mechanism or in the credit or other institutions rather than in direct balance of payments measures like exchange rate adjustment or changes in overall monetary policy. Through such measures, governments can avoid managing their balance of payments without the use of administrative controls that are either not workable, or are counter productive in achieving development objectives and still achieve the needed specific pattern of balance of payments behaviour needed for the development program. Exchange restrictions and multiple currency practices have a dismal record in practice, though their use often seems attractive and rational to countries in balance of payments difficulties. Government controls are not usually an efficient device for allocating scarce resources, while government policies designed to induce changes in consumption and investment by use of the incentive/market/price mechanism can be effective if accompanied by needed institutional changes.

There need be no conflict between achieving short-term objectives of avoiding unmanageable balance of payments deficits and achieving long-term

development objectives as long as domestic conditions are non-inflationary and exchange rates are kept realistic. It is in inflationary conditions that we are too often forced to choose between short-run balance of payments objectives and long-run objectives of social and economic progress. In some countries, the inflation is hidden by balance of payments deficits which are tolerable, e. g., because of favourable terms of trade and extraordinarily large foreign exchange earnings in relation to total import demand, e. g., in countries with relatively small populations. But these cases are exceptional, and even in these cases, the cost of persistent inflation for the development effort must be carefully assessed. The swollen import demand, though financed, may be at the expense of increased domestic savings available for investment in the future, even if not needed immediately for this purpose. Thus the imports may well be heavily weighted with luxury consumer items that are purchased by those who could be potentially larger savers or investors in present or future domestic productive enterprises, or help finance by voluntary savings or taxation present or future needed social overhead capital like schools and environmental protective devices.

In a well conceived development plan, i. e., which had passed tests for feasibility, exchange rates would not have to fluctuate (usually meaning devalued) because of persistent domestic inflation. Changes in exchange rates would be part of the implementation of the strategy of structural transformation — a phenomenon which does not occur quickly, i. e., in terms of months rather than years. This transformation may involve, for example, encouraging industrialization, modernization of agriculture including new exports, tourism, inducing greater exploration of mineral resources etc., causing major shifts in employment opportunities and income distribution. Similarly monetary reserve management and external short - term borrowing by the financial authorities would, from the developmental viewpoint, have as their central preoccupations avoiding disruption of the development program. Incidentally, it would enable countries to meet their international payments obligations and avoid restrictions on payments, but the focal point of attention would be the development program. The magnitude and composition of needed reserves would be judged by these criteria. In some cases, it might lead countries to wish to build up rather large monetary reserves when defined in terms of current payments because of foreseeable likely future needs; in other cases, for example, for exporters of oil, the need to hold monetary reserves may be regarded as minimal. The future composition of imports, as well as the anticipated levels of imports would

be important. Import substitution as a means of "saving" foreign exchange by high cost production for the domestic market would give way to import substitution only in cases where conditions in countries make possible in time efficient domestic production capable of producing export products and would not be at the opportunity costs of using the resources for other even more beneficial purposes.

Development programs could be designed which avoided inefficient import substitution if they were first submitted to the tests of feasibility suggested earlier. Foreign exchange gaps would exist, but their size would reflect the ability of the economy to make efficient use of the externally borrowed capital, whether directly in projects or in more general balance of payments support.

A central bank which conceives balance of payments management in this way will, parallel to the suggested broadening of its domestic expertise, have to broaden its knowledge of the external sector, if it has not already done so. The horizons of its responsibilities will be greatly widened, but it will be in the position to give realistic and relevant advice to government, or itself take the necessary domestic credit measures because it will now be surveying the entire economy including the external sector from the developmental viewpoint. Its giving advice and actions in these fields will come as no surprise to other government officials or to the public because the development strategy will be known and all will expect the balance of payments to be managed by the central bank to achieve these objectives. This means severing certain policy measures like changes in exchange rates from narrow political partisanship and obtaining general support for a technical approach to development issues.

In this context, balance of payments support from international sources would aim to enable countries to sustain their development programs when they are endangered by difficulties due to external developments or other causes beyond the control of the country like drought or floods. It is strictly analogous to enabling developed countries to follow full-employment policies, thus avoiding severe and prolonged inflation, and prevent consequent declines in foreign trade. As in the case of developed countries, persistent inflation would be taken as a sign of likely domestic mismanagement requiring correction in a manner designed to defend the development objectives if the inflation is due to such domestic mismanagement. The

international monetary agency (presumably the IMF) would make this judgment and presumably this would influence its judgment in providing support. Defending development is however, different from defending full employment in that the former is a long-run problem, while the latter is usually a short-run cyclical problem. This may well mean that the balance of payments assistance may need to be given on different terms. The terms should be based on the likely period needed to obtain the balance of payments results to repay the support obtained. In a developing country, achieving the ability to repay should not require cutbacks in sound development programs. It may well be desirable to subject such programs to international scrutiny to obtain the needed prior international consensus that the program is worthy of international support. The implementation of the development program together with world conditions will furnish the basis for deciding on appropriate terms and conditions of balance of payments support. This would extend the management responsibilities of the international monetary agency (or collaborating agencies). There would be a universal rule requiring servicing (or repurchase) of balance of payments assistance by all, but the provision of such assistance need not be on uniform terms.

Implications for the International Monetary System

The implications for the international monetary system whose reform is now under active consideration is fairly clear. The aim should be to have an international monetary system which helps the low-income countries achieve their developmental objectives in a manner which is mutually acceptable to all countries. This would explicitly give a developmental function to the international monetary system as it operates with respect to the developing countries. The international monetary system would also have other objectives such as the maintenance of full employment and the avoidance of persistent inflation.

Developmental criteria would be used as a basis for judging the appropriateness of balance of payments behaviour and management of low-income countries as long as the measures taken by them are not harmful to other countries.

Balance of payments support would be redefined both with respect to the conditions for support, magnitudes and terms of conditions. Performance criteria would now be related to developmental behaviour including creating conditions for improved savings, better allocation of resources and strengthening the export sector. As in the case of developed countries, avoidance of persistent inflation, the maintenance of realistic exchange rates and abstaining from restrictions on trade and payments for balance of payments purposes would be included among the performance criteria. The normal balance of payments behaviour of a developing country would be expected to be a continuing current account deficit financed by expected net resource inflow — at a level deemed reasonable by the international community.

To accomplish these objectives of the international monetary system, the mechanism for providing balance of payments support for sound development programs would need to be improved. Two gaps in balance of payments support for development may be particularly noted. One is the accessibility of adequate financing on appropriate terms to meet certain difficulties caused by external or exogenous factors or other circumstances beyond the control of countries. Such factors include net capital inflows below anticipated magnitudes, shortfalls in export earnings from agreed expectations, collapses in intenational commodity agreements, impact of international controversies, etc. Another gap in providing balance of payments support for sound development is the range of lending between approximately five to ten years. Development requires the entire spectrum of international financing, say from one year to fifty years and on all sorts of terms from commercial to official grants. Development financing includes general balance of payments support and budgetary support, as well as project lending. The sources of financing are also very varied including not only bilateral and multilateral aid agencies but also special forms such as the use of the Special Drawing Rights created by the International Monetary Fund.

The approach stated herein would result in the evolution of developmental criteria to govern the granting of balance of payments assistance in low- income countries. The appropriate internationl institutions would

need the authority to develop criteria and to apply them in practice. It would also need the authority to change these criteria as conditions change. The international institutions would have to have sufficient resources to make possible the defence of sound development programs in this way It would then be possible for the developing countries to participate in an orderly international monetary system.

The question arises as to whether the treatment of developing countries should be as exception to universal rules applying to all countries or done by having separate sets of rules. Either way is feasible and could serve the purpose. The important thing to recognize is that short-run balance of payments support is not enough and that development finance as now defined does not substitute for the inadequacies of existing short-run balance of payments support, though considerable progress has been made in such forms as the Fund's compensatory financing arrangements. Another key point to recognize is that all external support for a developing couutry has a developmental aspect. The developmental aspect arises from the impact of the support on the development program, and not from the financial terms on which the assistance is extended.

I have not spoken of a very important aspect of the monetary reform for the low-income countries, namely to provide a general international environment of expanding world trade, movements of capital, access to markets and technology, etc. Without elaboration, it may be summarily said that this is based on creating domestic and external conditions in developed countries which are conducive to their behaviour in this matter. The chief danger has come from the persistent inflation existing simultaneously in developed countries and the consequences for both the domestic conditions and balance of payments behaviour. The relatively frequent changes in exchange rates which major countries have to make in an environment of persistent inflation creates great uncertainties for the developing countries which usually have little choice except to adjust to the new conditions by following one of the major currencies. The international monetary system would greatly assist development in the low-income countries if it encouraged in the developed countries higher levels of

savings which facilitated capital exports as well as facilitated the maintenance of high levels of employment without the need for repeated restraining policies. Thus, there is no inherent conflict between a prospering world economy and defending sound development; instead they are mutually reinforcing.

I appreciate that I have not dealt at any length with a number of matters which preoccupy many in considering the subject on which I have commented. Much has been said and some useful suggestions made, for example, on the possible "link" between the creation of Special Drawing Rights and development financing. Others might well have given more attention to such questions as the implications for developing countries of stable versus fluctuating systems of exchange rates. (Implicit in what I have already said but to avoid misunderstanding, I may say very briefly that I believe that, generally speaking, it is in the interests of the developing countries that the international monetary system be based on a system of fixed but flexible exchange rates centred in a strong inter national monetary authority.) Still others might have given more attention to the interrelations between monetary and trade developments. I have chosen to dwell on those subjects which I believe are of fundamental importance for creating the overall environment which social and economic development requires and particularly those aspects which may tend to be relatively neglected. Perhaps it reflects the fact that my own experience has been greatly concerned with what is now called the international adjustment mechanism. It is the agreed rules regarding this adjustment mechanism which we call the international monetary system. It is into this mechanism that the developing countries have to be fitted. It may be argued that the less developed countries are not important for the international monetary system because of their relatively small economic size in world output or world trade. However, any international monetary system, however devised, is intended to last for some time, say, one generation or more. During this period of time, developmental problems of low-income countries, I am convinced, will become of increasing concern to the entire world. Unless a new international monetary system facilitates the process of social and economic development, future decades are bound to pronounce it a failure.

Irving S. Friedman

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F - Friedman speech book

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Books

Inflation as a self-fulfilling prophecy

As times change, the view of economic problems changes, but whatever the perspective, it seems that there is always an invisible, unreachable wall that keeps any economic system from attaining its primary goal: efficient, equitable satisfaction of the material needs of its citizens.

Early economists thought in terms of natural limits on economic well-being. Thomas Malthus long ago advanced the gloomy proposition that population would always grow to the limits of subsistence. In recent years, the Malthus thesis has been dusted off and restated. Many economists predict that exhaustion of the world's resources will impose increasingly severe limits on economic growth.

But that is somewhere in the future. In the present, most of the economies of the world have encountered an equally difficult and much more immediate barrier to progress: inflation. Since World War II, all prices have been on an escalator. The U. S. has made a far better record than most nations, but it too has been caught periodically in waves of inflation. At the moment, it is in the throes of an inflationary boom that shows no signs of abating.

Economist Irving S. Friedman, with a background of long service at the International Monetary Fund and the World Bank, took advantage of a sabbatical year as a visiting Fellow at Yale and at Oxford's All Souls College to consider the implications of the susceptibility of modern economies to inflation. In the pessimistic tradition of Malthus, Friedman is concerned that a disaster could be brewing.

Inflation
by Irving S. Friedman
Houghton Mifflin • 304 pages • $7.95

Inflation is not, however, a doomsday book. It carefully traces, in nontechnical terms, the causes and development of the wage-price spiral that caught up the whole world. It also lays out the hard choices that must be made if the corrosive effects of ongoing inflation are not to eat away "the fabric which we call society and civilization."

The trouble, says Friedman, is that governments and individual citizens think of inflation as an illness, something that can be lived with. Actually, it is a cancerous growth that requires radical surgery. Government policymakers must stop thinking that there is a trade-off; that some inflation is the inevitable cost of achieving an expansion in social services. There is no such choice. To accept inflation as unavoidable is to give the game away in advance and erode the very improvements in welfare that governments seek.

Irving S. Friedman

Friedman concludes that it is a grievous error to believe that inflation is truly under control when price increases subside from previously high rates to some lower rate. The short, unhappy life of Phase III bears out his point. The slowdown of inflation under Phase II was deceptive. The Nixon Administration thought it meant they could start getting out of the control business altogether. But as soon as they relaxed, inflation started roaring again. Whether the controllers learned the lesson remains to be seen. Even before the stronger Phase IV is emplaced, they are confidently looking ahead to Phase V, which is expected to be a no-hands operation.

In Friedman's judgment, the current inflation is the worst in history; it has deep roots that can be ripped out only after years of effort by the major industrial countries acting in concert. In order to really end inflation, says Friedman, it is necessary to first kill off inflationary expectations. That will be difficult indeed. The soaring price of gold reveals the universal loss of faith in national currencies.

Friedman sets out an order of priorities and a series of guidelines for governments to follow if they are to achieve an appropriate balance between supply and demand. Governments must make realistic decisions on the allocation of resources—and stick by them. And they must encourage capital investment. What is more, and this is a sticking point, governments must make a realistic division between public and private consumption.

The core of the inflation problem is excess demand. Rising expectations all over the world run ahead of the productivity potential as governments continuously pursue full-employment policies There is often little or no margin between production and capacity.

An essential requirement in controlling inflation is for governments to stop trying to do more than they can do. This used to be called budgetary discipline. Now it is referred to as demand management, a phrase we'll be hearing more of from Washington.

None of the recommendations, sound as they are, are new. They have been advanced at various times by students of the political and economic processes. But Irving Friedman puts it all together and serves it up in a provocative and compelling manner. *Inflation* is recommended reading for anyone interested in the anatomy of inflation. It should be required reading for government officials and legislators.

—William B. Franklin

William B. Franklin keeps a constant watch on inflationary trends and reports them in the weekly Business Outlook pages of this magazine.