FINANCE AND DEVELOPMENT

A Hard Look at Development Planning
Currency Unions—Pro and Con
International Liquidity and the Fund
Stabilizing an Economy: Finland
What Does It Really Mean?—Multiple Currency Practices
Africa and the European Economic Community
Coordinating Aid to Developing Countries
Japan and Israel

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(An article on Finland’s economy appears on page 107)
A Hard Look at Development Planning

A World Bank expert advises a new appraisal of development planning from an unfamiliar vantage point—practical experience.

Albert Waterston

In an attempt to determine where, when, how, and why development planning has been successful, a small group within the World Bank has since 1958 been examining data for countries throughout the world—over 100 countries, developed and less developed, in Africa, Asia, Europe, and the Americas, including socialized as well as mixed-economy countries. Out of this great assemblage of raw material, a comprehensive comparative study was published in December 1965.¹ Those who are interested in development planning are now able to consider not only how it might be done but how in fact it has been done.

While countries about to start planning their development can learn much from the planning experience of other countries, few make use of this experience: this is the first lesson of the study. The reason, in part, is that the experience of other countries is not known; but mostly, it is because countries will not be guided by the experience of other countries, since they consider their own political, economic, and social conditions to be unique.

Yet the study reveals that most countries not only encounter the same planning problems; they make the same mistakes. They frequently confuse the mere formulation of a plan with planning, fail to take adequate account of what can be done, and hence plan for less than is realistic in some sectors and more than is realistic in others. They have their planners take on extraneous tasks which divert them from planning, set up unsuitable planning machinery, set it up in the wrong places, and so forth.

Plans Versus Planning

Planning has undoubtedly promoted development in many countries. But postwar history reveals that there have been many more failures than successes in carrying out development plans. Indeed, among developing nations with some kind of market economy and a sizable private sector, only one or two countries seem to have been consistently successful in carrying out plans.

Except for short periods, most countries have failed to realize even modest income and output targets. What is even more disturbing, the situation seems to be worsening instead of

¹ Albert Waterston, Development Planning: Lessons of Experience (Baltimore, 1965).
improving. In Asia, where countries’ experience with planning has been greater than that in any other region, the rates of growth in the early 1960’s fell short not only of targets but even of the growth rates of the 1950’s. The situation is not very different in the other continents.

While most countries with development plans have not succeeded in carrying them out, some countries without national development plans or national planning agencies have been developing rapidly. For example, Mexico between 1940 and 1955, when it had no planning agency or plan (and even until now, since in fact it has no plan to which the Government adheres), maintained an annual average rate of growth of 5-6 per cent. Israel, which had no plan before 1961 and still does not have one which the Government follows, has been able to maintain an even higher growth rate. Puerto Rico has become a showcase of development without benefit of a development plan. And among the more developed countries, Germany, without plans, has increased income and output at least as rapidly as France with plans.

It could be contended—and I do contend—that if these countries had had development plans they might have done even better. But the fact is that a country can develop with or without a plan.

A development plan, however, is not the same as development planning. Planning as a process involves the application of a rational system of choices among feasible courses of investment and other development possibilities based on a consideration of economic and social costs and benefits. These may or may not be put into writing in a “plan.” Those who equate a development plan with development planning—and they are many—confuse what should be a product of the planning process with the process itself. A plan can play an important part in the planning process when it makes explicit the basis and rationale for planning policies and measures. But if a plan is prepared before the process has begun in earnest or is unable itself to generate the process, it is likely to have little significance for development.

**Importance of the Political Factor**

Why are so few development plans carried out? Lack of government support is the prime reason. This lack of support manifests itself in many ways, among them the failure to maintain the discipline implied in plans and the failure to adopt appropriate policies for carrying them out.

Sustained governmental commitment is a *sine qua non* for development; this is cardinal. Pakistan’s experience, for example, gives dramatic evidence of the overriding importance of government support. Although the planners of Pakistan’s First Five-Year Plan produced a development plan with targets well within the limits set by economic and financial resources, the Plan did not get very far because it did not have help from the Government. Given support from a strong and stable leadership, the Second Five-Year Plan overfulfilled its main targets.

Experience in other countries has been similar. In the nineteenth century, Japan, with fewer resources than Burma, China, India, or Indonesia, nevertheless became the most industrialized country in Asia. In large part, this was because of sustained effort supported
by a determined Government. In the twentieth century, the histories of such diverse countries as the Republic of China, Israel, Mexico, Mainland China, the U.S.S.R., and Yugoslavia give ample evidence of the importance to a country’s development of firm and continuing support from a stable government.

**Economic Incentives**

Until the political leaders of a nation become committed to development, the people themselves are unlikely to show much interest. If a country’s leaders make development one of their central concerns, experience shows that the people’s interest can be obtained. But except on occasion—for example, during or immediately after a war or other catastrophe or upheaval—interest is not likely to be obtained through appeals to their patriotism, devotion to abstract ideals or altruism, or panegyrics about individual or group accomplishments. Direct government controls over economic activity, or threats of imprisonment or other punishment, are also generally ineffective.

The evidence teaches that the best long-run method of getting people to act in such a way as to achieve plan objectives is to make it profitable for them. Where governments have replaced administrative controls by economic incentives, the result has usually been accelerated economic activity. In Pakistan, for example, government officials as well as outside observers agree that administrative restraints hampered industrial growth during the First Plan period. They also agree in attributing the high rate of industrial progress during the Second Plan period largely to the reduction of government controls over imports and foreign exchange and the introduction of a system of tax incentives and bonuses which encouraged businessmen to expand capacity and output. In Pakistan’s agriculture, also, the use of incentive prices played an important part in increasing production.

Since the early 1950’s, when Yugoslavia replaced centralized controls based on the Soviet model with decentralized management of the economy, that country has evolved a system of economic incentives based on tax, credit, and price policies by which workers and enterprises are rewarded in accordance with their efficiency. These incentives have done so much to raise production that other Eastern European countries, notably Czechoslovakia, but also Poland and Hungary and even the U.S.S.R., are moving toward the Yugoslav system.

In contrast, many governments in countries with mixed economies rely on direct controls and administrative intervention in the private sector in preference to incentives, and often depress their economies as a result. The problem now is how to get the mixed-economy countries to readopt the system of economic incentives that the socialized countries seem to be taking over from them.

**Separation of Plan Formulation from Implementation**

Economic development is so difficult that, if political leaders are not very deeply committed to it, the plans which they approve are not carried out because no provision is made for carrying them out. Prime Minister Jawaharlal Nehru of India, who as Chairman of the Indian Planning Commission showed an uncommon grasp of planning problems, once pointedly remarked, “We in the Planning Commission and others concerned have grown

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more experienced and more expert in planning. But the real question is not planning, but implementing the Plan . . . . I fear we are not quite so expert at implementation as at planning. . . . This statement is notable not only because it recognizes—correctly I think—that the problems of plan implementation are more difficult than those of plan formulation, but also because it distinguishes—wrongly I believe—“planning” from “implementation.”

The word “planning” is often used, as it was by Prime Minister Nehru, to refer to the formulation of plans, but not to their implementation. The conceptual separation of “planning” from “implementation” is more than a question of semantics: it is symbolic of an attitude which is unfortunately prevalent among planners. Experience shows that nothing hampers the success of development plans more than the separation of plan formulation from provision for implementation. Planning cannot leave off where plan formulation ends and action to execute a plan begins. Every target must be accompanied by policies and measures which have been devised specifically to fulfill it; otherwise it becomes only a forecast or projection.

The link between the targets of a plan and the policy and other measures required to attain them is one which many planners and political authorities find difficult to grasp. There is frequently a lack of understanding in developing countries that investment is not enough to ensure growth, that appropriate policy, administrative, and organizational measures are almost always more important for development than is higher investment.

Most plans are prepared in central planning agencies whose officials have little authority over economic policy that is formulated elsewhere. Consequently, one often finds countries where tax, price, monetary, and credit policies impede rather than help to realize plan objectives. For instance, in Pakistan’s First Plan, agricultural price policy discouraged farmers from planting crops whose output the Plan sought to increase.

Discounting Overambitious Plan Targets

A planner may not be able to do much about a government’s administrative inefficiency and its lack of political commitment or will to develop. But if in preparing his plans he ignores these critical factors, which together constitute the main limitations on the ability of most less developed countries to realize their economic possibilities, he ends up by separating his activities and the plans he formulates from the real world that has its being outside of national planning agencies.

This is precisely what happens in many less developed countries. National development plans are based on a country’s economic potentialities or its needs as determined by population growth, and are little related to the country’s administrative capacity, or to the government’s will, to carry them out. In these countries, plans are not so much blueprints as hortatory instruments. It can hardly be surprising, therefore, that most planning aims are never achieved. Because the aims are related to what is possible or desirable, with little regard to what is likely, they are usually set so unrealistically high that they never have a chance. For instance, in Bolivia’s Ten-Year Development Plan for 1962-71, the target of average annual increases of 9.2 per cent in gross national product in the first five years
may have been economically possible, but it was far beyond the country’s administrative and political capacities. The Government wisely abandoned it as overambitious.

If planners are to set realistic targets in their plans, they must somehow find means to measure administrative inadequacy and the lack of political will to develop, so that they can “discount” the unduly optimistic targets set when plans are formulated solely on the basis of economic potentiality. This sounds difficult, but it is not impossible. For example, it is possible to quantify the cost of administrative inefficiency, in terms of money and time, on the basis of past discrepancies between original estimates and actual performance in projects and programs. By deflating the estimates by a factor based on past errors, such adjustments can go a long way toward closing the gap between promise and performance.

Similarly, it is possible to quantify a country’s political will to develop if planners set up for each major area of policy (e.g., taxation, credit, investment, money, and incomes) feasible alternatives, including the effects of each on development, from which political authorities can make a choice before a plan is drafted. In the process of selecting the alternatives which best suit them, the political authorities will be supplying specific information about the extent to which they are prepared to adopt policies and other measures for furthering development which, collectively, can be said to constitute a veritable measure of their “will to develop.”

If the three basic elements that enter into the planning process—economic potential, administrative capacity, and political will to develop—are all taken into account in formulating plans, planning aims are bound to be more in line with a country’s real capacity to achieve its economic potentialities.

The Projects Problem

The current artificial separation between the formulation and implementation of plans accounts for the failure of planners, concentrating as they do on aggregative planning, to recognize soon enough that the weakness in most developing countries is not the lack of an elegantly integrated comprehensive plan based on economic potentialities but the lack of well-planned individual projects that can really be carried out. For example, after 18 months of work on Bolivia’s Ten-Year Plan, the planners found themselves in the embarrassing position of conceding that “the principal deficiency that will be noted in the formulation of the present Plan is the small number of specific investment projects . . .” needed to execute it. Similar statements can be found in the plans of many other countries.

Because it usually takes several years to identify and prepare a sufficiently large number of good projects needed to implement a plan, it is too late for planners to become concerned about them after a plan has been prepared or even when it is being formulated. Unless preinvestment and investment studies of projects for implementing a comprehensive plan are sufficiently advanced, it does little good to prepare such a plan. Yet all too often this is exactly what happens. Few projects are carefully worked out before the work of implementing them begins. As a result, many

projects and programs are not carried out at reasonable cost and in reasonable periods of time. Attempts to reduce the time spent in preparing projects frequently result in the choice of low-yield projects; substantially increased costs and delayed construction because of technical or other problems that were not foreseen; poor phasing of raw material, transport, staffing, or other requirements; failure to provide adequate financing; shoddy construction; and inability to make full use of completed projects.

Only a few of the less developed countries are fully aware of the need for selecting soundly conceived projects with potentially high yields, defining their scope with clarity, estimating their national currency and foreign exchange requirements with a sufficient degree of accuracy, and laying down realistic schedules for their execution; even fewer have the administrative capacity and the political will to cope with these needs and, especially, to carry out the projects in accordance with carefully developed programs of action.

**Changing the Planning Mix**

One reasonable conclusion to be drawn from experience is that it may be desirable to reverse the usual proportions of the planning mix. Planners have almost invariably concentrated on aggregative planning rather than on the proper preparation and execution of projects, but experience shows that countries with well-prepared projects coordinated by sound budgetary procedures and controls can dispense with comprehensive plans, at least for a time, and still maintain high rates of growth. It seems clear, therefore, that improvements in project preparation and budgetary controls, where needed, are at least as urgent as the preparation of aggregative plans.

These findings obviously have an important bearing on the sequence in which planning problems ought to be attacked. If the planning process is to be realistic, planners must not start, as they often do, with a series of theoretical abstractions of planning as it ought to be, and they must not try to force these ideas in an inhospitable environment where governments are unstable, not genuinely committed to development, or otherwise unready for aggregative planning. Instead, while not forgetting the long-run objectives that theory demonstrates to be desirable, they must—at least at first—attune their plans to “things as they are.”

**Improving Planning Organization**

Since effective projects should be prepared in the agencies that will actually carry them through, the organization of programing units in these agencies should get much higher priority than it now has in many developing countries, perhaps even higher than central planning agencies. Improved budget offices also may be more important in these countries than improved central planning agencies.

**Changing Technical Assistance**

The type of technical assistance needed for preparing technically and economically sound projects, and executing and operating them, differs from the type of technical assistance that has been supplied for aggregative or comprehensive planning. Aggregative planning is a business for economists who need only a modest knowledge of agricultural and industrial techniques; but project preparation re-
requires engineers, agronomists, and other technicians, including some who are capable of translating financial costs and benefits into economic costs and benefits.

Because the preparation, execution, and operation of projects involve many people in a government, it is becoming imperative that foreign technical assistance be largely made up of “demonstrators” rather than “doers.” Doers can be used for a few special purposes, but only demonstrators working on the job with groups of government employees actually engaged in project preparation and execution can hope to train in a reasonable period the large numbers of workers who must become involved in project preparation, execution, and operation.

What I have written is not an attack on comprehensive planning. Ideally, planning should be undertaken “from the top down” as well as “from the bottom up.” But experience reveals that in most countries planners begin with the first and rarely get around to the second. Since planning from the bottom up is essential to development, while planning from the top down is not, it seems sensible for a country to begin with the preparation of sound projects and sector programs and, with these as a foundation, to advance toward comprehensive planning as rapidly as circumstances permit.
Currency Unions—Pro and Con

While the countries of Western Europe and Central America ponder on whether their currencies should be united, countries in Africa can offer some practical lessons based on experience with currency unions.

J. V. Mládek

The issue of a common currency—or a currency union—appears on the agenda in three continents: Europe, America, and Africa. It figures in the program of the European Economic Community, although there are few signs that it is considered urgent. In Central America, it is being discussed within the framework of proposed economic integration, toward which some steps have already been taken.

Africa is the only continent which can boast real live currency unions: the West African (CFA franc), the Equatorial African (CFA franc), and the East African (shilling) currency unions. Of these, the last is preparing for liquidation, following the example of three other unions which expired at about the time of their members’ accession to independence. Africa can therefore offer some lessons based on practical experience with currency unions, which may be of interest to developing areas.

Currency Union and Economic Integration

A currency union in practice is either an instrument of economic integration or a feature of an already existing economic union; in recent history there has been no instance of a currency union whose members have not at the same time observed the rules of a common market. This is true of both the West African and the Equatorial African currency union, and it is still largely true of the East African currency union. Nor is there any plan for a future currency union which would not be accompanied by a common market, thus forming an economic union.

Plans for economic integration in Europe and in Central America recognize that a currency union cannot be envisaged until integration is well advanced, although a unified currency may be expected to stimulate integration. The degree of economic cooperation required in order to achieve a currency union makes it a waste of time to discuss plans for common currencies in vast areas where individual countries have not taken the first steps toward bringing their economies any closer together—and perhaps could not do so if they tried.

What advantages does a currency union offer to its members? Its main merit can be appreciated only on the basis that amalgamation of small economic units into large ones is desirable.
Currency Unions

Economic Integration: Advantages and Drawbacks

If the desirability of such amalgamation is accepted, two further questions may be asked: First, what are the benefits of having an economic union? Second, what are the advantages of a full economic union—including a common currency—over a less complete form of union, such as a common market?

The basic claim of the partisans of economic integration is easy to understand. The stepped-up competition resulting from the abolition of protective restrictions leads to increased specialization, efficiency, and productivity. The factors of production—labor and, particularly, capital—are used more efficiently, and the enlarged markets make possible the application of modern technology, which often depends on the so-called economy of scale, that is, on plants whose optimum size is relatively large. When these claims are made good, a common market has already achieved considerable success.

What does a common currency add to such an achievement? In theory, a common market establishes freedom of movement for products and factors of production across member countries’ borders, thus unleashing the forces of competition. In practice, however, it is possible for any common market to have many imperfections, so that it stops short of complete freedom for products and factors, as illustrated by the European Economic Community. Under one currency, some of these imperfections could not survive, and others would be subject to new pressures. The very first consequence of having a single currency is, of course, that it allows complete freedom of payment by any one place to any other place in

TERMINOLOGY used by different authors in this field varies; the present author offers his own definitions without claiming universal validity for them. All the definitions are of ideal concepts; in existing arrangements there are many exceptions to rules.

A currency union is an arrangement between two or more sovereign states to share the same currency and responsibility for its management. (A country may use another country’s currency without participating in its management, but that is not a currency union.)

A further distinction should be made between currency unions and what used to be termed monetary unions in the nineteenth century. All member countries in a currency union use one single currency. Countries in a monetary union—such as the short-lived Latin Monetary Union and the Scandinavian Monetary Union of the nineteenth century—use separate currencies that are freely interchangeable at fixed rates. As long as the rules of a monetary union are observed, the difference between the currency union and the monetary union appears, at least in theory, to be slight. In practice, however, there is a difference.

A customs union is an agreement between countries to remove customs tariffs on trade between members and to create a common customs barrier vis-à-vis the rest of the world.

A common market means a free market for the goods and services produced by its members and also for the factors of production, that is, capital and labor. There are no quantitative restrictions or multiple rates of exchange and no customs barriers, the rules of a customs union being part of the whole structure.

An economic union is a combination of a common market and a currency union. There are no restrictions on the movement of products or factors and there is one currency.
the union; thus a currency union gives complete liberty to capital movements, which under a common market may still be restricted. To an investor, besides providing him with freedom to move his money as he thinks best, the currency union brings another gift: guarantee against a devaluation loss. Even under full interconvertibility of currencies of countries in the common market, a change in par values remains a real possibility, a threat which is finally removed only by the unification of the currencies. This is indeed the great advantage of a currency union over a monetary union.

What applies to capital is equally true of the earnings and savings of labor and should encourage migration across national borders. Payments within a union would become swifter as exchange controls were shed.

The happy expectations of benefits which economic integration may bring are not, however, equally shared in all quarters. There has been considerable controversy about the extent to which the benefits are offset by switching from less expensive foreign markets to the more expensive (because less efficient) suppliers within a union. Furthermore, an economic union, or a common market, may over-protect its area and thereby tend to create unsound industries. Essentially, these are arguments against excessive protectiveness, but it is true that the very process of integration, through the elimination of internal barriers and the maintenance of external ones, involves some losses which have to be subtracted from the benefits.

Some critics of integration plans, while not attacking the theory, argue that local circumstances often prevent the plans from working. They say, for instance, that migration of labor will not act as an equilibrating factor in payments between member countries because tradition, language, and religion will discourage it. Other critics, while not doubting that the integrating process will work, are disturbed by some of the results that they expect from it. Thus, mobility of capital may be harmful if it results in capital being attracted to more developed areas rather than to the neglected ones which need it most. So integration may actually increase the uneven geographic distribution of incomes and wealth.

Yet often, opponents of integration—especially if their opposition is political—take their stand on other grounds and stress the loss of freedom of action which integration would entail for national governments. This argument, politically sensitive and therefore of consequence, deserves analysis.

Integration and Sovereignty

The simplest way of describing what happens to governmental prerogatives in the process of economic integration is to list the weapons that a sovereign government possesses for the defense of its balance of payments and to show which of these weapons the country has to give up when it enters an economic union.

The government of a fully independent country that experiences an upset in its balance of payments can take any number of measures to set it right. It can cut down outlays on imports by applying import restrictions, imposing import taxes, or raising tariffs. On the receipt side of the balance of payments, it may attempt to boost exports by providing subsidies or by introducing a specially favorable exchange rate for exports. Finally, if the
Currency Unions

trouble is persistent, it may devalue its currency. With the exception of devaluation, external measures usually appear easier than attacking the root of the problem through internal action, which is directly felt and resented by the population, or at any rate by the business community. If it is assumed, for instance, that the cause of the balance of payments disequilibrium is a too ambitious development program, the correct remedial action would be to slow down the pace of investment or possibly to review the program and supervise spending more closely. More likely than not, the lowering of aims will be unpopular; a decline in the volume of public works may easily affect working opportunities for labor, and the resulting reduction in consumption may be resented in business circles. Faced with the possibility of political trouble, authorities often tend to delay the unpleasant moment and to rely for the time being on external expedients.

All such external measures are barred to a country in an economic union. Even a common market considerably reduces a member country's arsenal of defenses. While the government would maintain the right to devalue its currency and might retain some freedom to regulate capital outflow, it would be unable to impose any form of restriction on its imports and current payments without explicit authority from its fellow members of the common market. The country in our example could not raise its external tariffs above the common tariff level, and it might find that restrictions on imports from third countries were ineffective unless internal controls were reimposed on the movement of goods within the market. Short of going from one devaluation to another, our country would discover that its development policy, and for that matter its employment policy, must be coordinated with the policies of other member countries.

Should the common market graduate to a full economic union because its members have signed a treaty establishing a common currency, the country in question would have to give up its last external instruments of defense. It would be unable to devalue, and it could not impose any restrictions on capital movements.

What freedom of economic policy is left to member countries on the internal front? If they have free banking and free mobility of funds, only limited differences in credit policy are conceivable. Differences in taxation are possible, provided, however, that they are not so big as to drive labor or capital to the areas of lighter taxation. Even a country's budgetary policies become a legitimate interest to its fellow members in the union. As a matter of course, deficit financing in one country, whether by the banking system or the central bank, would be watched with attention by all other members of the union. Monetary expansion in one country alone would increase that country's share in the union's products and resources. It would be tolerated only up to a point, beyond which it would be challenged by the other members. In practice, precautions would almost certainly have been taken at the outset to prevent such a contingency by centralizing credit policies in a central monetary authority and possibly by setting a fairly strict limit on the credits which the common central bank could grant each member government.

A country's inability to escape from economic difficulties by settling its own policies may sometimes be a real privation. A mone-
tary policy which is right for most of the union may be wrong for one particular country or area. Such a situation can arise even within a country, where the interests of one region may clash with those of others. But it is far more dramatic in a union of sovereign states where the remedies, such as migration, are less easy to put into motion. In sovereign states, too, social discontent can easily take on nationalistic overtones. The answer to this problem seems to lie mainly in intermember arrangements for relief action, which in developing countries would usually be connected with machinery for stabilizing incomes.

**Requirement of Discipline**

The requirement of a thorough coordination of policies, the transfer of so many prerogatives of sovereignty from member governments to central organs, is a price that some consider forbidding. Yet it may be asked whether the discipline and restraint which an economic union imposes on its members is really an entirely negative aspect of integration, especially for the new countries. In “Why a Central Bank?” (Finance and Development, Vol. II, No. 3), J. Keith Horsefield called attention to countries’ experiences with central banks over the last 40 years. In 1920, the international financial conference at Brussels recommended that every country should set up its own central bank. The recommendation was made on the assumption that national central banks would be able to restrain their governments from unwise policies.

But this hope has not been entirely fulfilled since then. While the restraining influence of central banks has often been exercised, the banks’ powerful credit instruments have frequently been misused and have tended not to counteract, but to accentuate, the bad effects of government policies. The existence of a central bank, with its limitless power of creating money, often seems to encourage government laxity about deficits, and this arouses doubts whether national central banks in the hands of inexperienced, irresponsible, or weak governments are much of a blessing.

Experience shows that governments seldom resort deliberately to inflation, but that, although aware of the perils involved, they are unable to resist political pressures and that they would actually be helped by a constitutional stop sign. Some countries have such a stop sign in the form of central bank laws banning certain policies or limiting the government’s borrowing powers. In other countries, however, where inflationary deficits have become something of a habit, the national monetary authorities no longer have such signs. It is clear that, as a restraining influence, a multinational central bank is in a considerably stronger position to take an anti-inflationary stand against one or several governments than is a national institution that has to face its one and only government. It is not easy for an individual country to disregard a warning from a multinational bank that it must not damage the common currency by allowing excessive expansion in a part of the territory. A government that is eager to avoid inflation, but fearful of taking alone the full responsibility for refusing excessive demands, may actually find relief in the firm policy of a multinational central bank and possibly in the statutory limits on the central bank’s credit to the government. Furthermore, in such situations a government, in answering its critics, would also be able to use to some advantage the weight of public
opinion in other countries. Undoubtedly, a violent disagreement between governments on budgetary and monetary policies might bring about a breakup of, or secession from, the union at any time. On the other hand, if the members of the union manage to avoid harsh actions over the years, a tradition of reasonableness may grow up and tend to eliminate crises.

Institutional Cost

Partisans of economic integration often mention among its favorable consequences the reduced duplication, and hence the reduced cost, of centralized agencies. While the saving on the cost of public administration is a minor consideration in the developed countries, it is of considerable consequence in the developing countries, most of which lack skilled personnel as well as funds. The Common Services Organization in East Africa is an example of efficient and inexpensive administration in several countries of tax and customs collection, transport and mail, and some other services. The central banks in West and Equatorial Africa are other examples of efficient, very inexpensive organizations, which, far from being reduced to the basic essentials of central banking, provide for their member countries valuable statistical and research services.

Development

Does economic integration help economic development? It has been pointed out by many that, unlike the countries of Western Europe, most developing countries pondering the possibilities of economic integration have little mutual trade and little industry. Free trade within these areas would not, it must be admitted, bring their production under the purifying flame of competition with industries in developed countries. The most obvious favorable consequence of integration would be the creation of markets large enough for modern industrial enterprises and of the modern infrastructure needed for economic growth. Yet an economic union, while creating more favorable conditions for new industries, does not in itself make redundant the efforts of governments to carry out purposeful development policies. Even in an economic union it is possible to live insouciantly, especially under the umbrella of foreign aid, or jealously and wastefully to duplicate a neighbor’s projects.

The problem of capital movements may be a serious one for developers in an integrated economy. If directed exclusively by investors’ choice, such movements may result in the further accumulation of the means of production in more developed regions and perhaps in stagnation or even backsliding in less favored areas. This anxiety was in fact one of the main causes underlying the dismantling of one important economic union in Africa. It appears unlikely that the process of industrialization could be left entirely to investors’ decisions. It may be hoped that an acceptable distribution of resources can be achieved through agreements between member governments on such means of channeling investments as are not likely to discourage capital.

Thus, in the last analysis, promise of full and balanced growth is to be weighed against the hardships of economic discipline and the need for uniformity in policies. Economic union is possible only for countries that think alike on political and economic questions. Discipline, while strong, must also be flexible,
which seems to be possible only in an atmosphere of mutual sympathy.

Although the form of the future political organization of Europe is now, more than ever, clouded by conflicting views, there is little doubt that the founders of the movement for European unity were moved not only by economic considerations but also by the desire to cement inter-European relations and to restore Europe to its position of influence among the world powers. In Central America, there is a memory of a common past, political kinship, and a community of language and culture between the countries. In Africa, where the unions have come into life not through a long effort of integration but by accepting and modifying a heritage from preindependence times, the success and survival of the remaining economic unions will be determined in the first place by their ability to develop among their members a strong feeling of common loyalty.
International Liquidity and the Fund

An address by the Managing Director of the International Monetary Fund before the Commercial Club of Chicago, March 24, 1966.

Pierre-Paul Schweitzer

I am happy to accept your invitation to speak to you today, and I particularly welcome your interest in the subject of international liquidity. Only a few years ago this subject would have been of interest only to a few specialists in academic circles and to those groups with a particular interest in international monetary matters. It is, I think, a sign of the times that today I am speaking about this subject at the Commercial Club of Chicago, for there is now a clear recognition that what happens in the field of international liquidity is important not only to governments and central banks but also to all who are concerned with commercial and financial affairs. It is of importance not only to the course of national economies but also to the economic health and stability of all major trading communities. I think that it would be helpful if I start with a definition of liquidity and proceed to a description of the nature and work of the International Monetary Fund as it relates to liquidity. I shall conclude with a few observations on the present position of the international discussions on liquidity.

Nature of International Liquidity

When we speak of international liquidity, we do not include a great deal of the financing of the international commerce of the world, important though this is. That is, we exclude from the concept of liquidity the vast complex of private foreign exchange holdings, bank credits and trade credits which give day to day support to international trade. We exclude also the government credit supplied for export purposes by bodies like the Export-Import Bank of Washington, as well as the long-term international financing which is channeled through the private capital markets of the world or through international organizations, such as the World Bank. As the term is used, international liquidity is not any of those, even though all of them have an effect on the need for liquidity.

What, then, is international liquidity? International liquidity comprises all of the financial resources and facilities available to the monetary authorities of individual countries to use in settling deficits in international payments—to use, in other words, to make residual payments in foreign currencies when all these other sources of funds do not make the accounts balance. Liquidity includes the well-known components of “official reserves”: gold that is held by central banks, but not that held by private individuals or businesses, and foreign currencies held by central banks or Treas-
uries—mainly dollars and sterling but also some other currencies, notably French francs. The International Monetary Fund is also a source of liquidity, of two types: one of these is regarded as similar in character to the reserve assets I have just mentioned, and the other is credit facilities subject to certain conditions. I shall describe these in more detail in a moment. Liquidity is also provided by credit facilities in other international institutions or under various bilateral agreements. It is upon this supply of gold, foreign exchange, and access to means of making foreign payments that the authorities of a country rely to finance imbalances in its international accounts.

“Liquidity is the Business of the Fund”

I turn now to the Fund. I have said on other occasions that liquidity is the business of the Fund—indeed, it was created to provide a pooling of gold and currencies which could be used to supplement the other reserves of its members. I have spoken of two forms in which the Fund provides liquidity. To explain these requires some description of the structure and activities of the Fund. The structure is unique. The Fund is an international financial agency, in which each member country—at present 103—has a quota. For each country, the quota is related to the size of its economy, its importance in world trade, the amount of its monetary reserves, and so on. The quota provides the basis for many of the country’s rights and duties as a Fund member. Thus, for example, the quota determines the size of each member’s subscription, which must be paid partly in gold and partly in its own currency. The quota also provides the basis for the amount of financial assistance which the member can obtain from the Fund, and for determining its voting power in the decisions of the Fund. In other words, there is weighted voting in the Fund, the members with the largest quotas having the most powerful voice. We are now in the process of increasing the quotas of Fund members from a total of about $16 billion to about $21 billion, and the quota of the United States is about one quarter of that latter figure. I should add that the Fund also has the power to augment its resources by borrowing, and has in fact done so under stand-by arrangements that it has negotiated, totaling the equivalent of $6 billion.

The basic purpose of this vast pool of financial resources is to provide member countries with a source of temporary assistance to meet deficits in their balances of payments. Financial assistance from the Fund takes the form of an exchange transaction, in which a member country draws from the Fund the currency of another country, and pays to the Fund the equivalent amount in its own currency. The total assets of the Fund are thus kept intact, although their composition keeps changing. Furthermore, the assistance is meant to meet relatively short-term difficulties, and there are therefore rules and understandings that repayment will be made, either in keeping with the rate at which the country’s position improves or in any case within three to five years. Repayment takes the form of reversing the exchange transaction which made the assistance available: the member country repays the Fund in gold or some acceptable currency, and the Fund returns to the member the equivalent amount of the member’s currency which it acquired in the earlier transaction. I realize that this sounds somewhat complex, but in a moment I shall give an example of how these operations take place.
Since the Fund is unique, no analogy with familiar institutions can exactly portray its financial transactions. But a loose comparison can be made, in order to illustrate the Fund's contribution to liquidity, with the relations between a customer and his bank. At any given time an individual may have a credit balance in his bank, or he may have an outstanding borrowing. There is something very similar to this in the Fund. Under established Fund policy, a member may draw virtually on demand against what we in the Fund call the "gold tranche." The gold tranche, initially equal to the member's gold subscription—generally 25 per cent of its quota—increases as the Fund uses the member's currency for the assistance of other members, and decreases if the member itself makes a drawing. Thus, it can be seen that it is not a static facility. What the member draws against its gold tranche is not in fact gold, but the currencies of other members, as I have indicated.

Example of Transaction with Fund

A gold tranche drawing by Mexico can serve as an example of a transaction with the Fund. In the middle of 1961, Mexico's quota in the Fund was $180 million, and it had no drawing outstanding. One quarter of that amount—$45 million—was the equivalent of Mexico's gold subscription; the other three quarters represented a subscription payment in Mexican pesos. In August of 1961, Mexico purchased 45 million U.S. dollars from the Fund and paid into the Fund some 560 million Mexican pesos—the equivalent of 45 million dollars at the par value of 8 cents a peso, established with the Fund. However, the Mexican economic situation improved very rapidly, and only a year later Mexico was able to reverse the transaction in accordance with the rules and procedures of the Fund. Mexico repaid the 45 million dollars in gold and six foreign currencies. At the same time, the Fund returned to Mexico the 560 million pesos received earlier, and Mexico's position in the Fund reverted to the 1961 position. I have not gone into all the technical details surrounding this operation, but I think I have said enough to illustrate how drawings on the Fund operate. This example also illustrates another important aspect of the Fund: its pool of gold and currencies is a revolving pool. Dollars were available to Mexico when needed; after the drawing had been repaid, the currencies received were again available in the Fund to assist other countries. I may add as a footnote that, as the Mexican peso has gained strength in recent years, the Fund has been able to consider the peso available for drawings by other countries, and one such transaction has taken place.

The understanding that "gold tranches" can be drawn against virtually on demand makes them valuable parts of the monetary resources of countries possessing them. An increasing number of countries are including such drawing rights in their official reserve figures, along with the gold and foreign exchange which they own, or present them in conjunction with these assets. The United States is one of these.

But what about the countries which have already drawn against their gold tranches? They have the right to ask for further temporary drawings of foreign currencies held by the Fund, in return for an equal amount of their own currencies. These further drawings involve a situation closer to that of a borrower.
in our banking analogy. And, as any banker and his customers know, bank loans are subject to certain undertakings on the part of the borrower. The Fund expects any member requesting assistance against its credit tranches to be taking active steps to restore its external payments to a healthy balance, and the larger the amount required, in relation to the member’s quota, the more stringent the criteria which must be satisfied. We call these drawings rights against credit tranches “conditional liquidity,” because of the conditions that must be met in order to exercise the right to draw. Members do not regard this type of liquidity as quite equal to freely available reserves, and do not include it in their international reserve figures, but it would be difficult to exaggerate the importance of these facilities for each member and for the international monetary system as a whole.

**Two Kinds of Fund Liquidity**

The two kinds of liquidity which the Fund provides are therefore drawing rights in the gold tranche—“unconditional liquidity”—which can be considered on the same level as other types of reserves, and facilities of “conditional liquidity” which are available only (to put it bluntly) where there is good performance or the promise of improved performance. It must not be thought that conditional liquidity is not useful because it is conditional. Members of the Fund know by now the circumstances in which they can use their drawing facilities, and their ability to do so is a source of strength to them. The current general increase in Fund quotas which I have mentioned will therefore add to liquidity, and will help all the Fund’s members feel a little more comfortable about their ability to meet adverse developments in their external payments positions.

This conditional liquidity is also important in another less immediate respect. The direct and immediate purpose of a drawing on the Fund is, of course, to help the country which requests the drawing. But more likely than not, the currencies which it draws will be those of economically strong countries which already have gold tranche positions in the Fund. In such cases, when the Fund agrees to drawings of their currencies, those countries acquire equivalent additions to their gold tranche positions, which may be useful to them at a later date.

This was dramatically illustrated early in 1964 when Italy met balance of payments difficulties. Italy’s gold subscription to the Fund was the equivalent of $67 million, and in 1959 this was the amount of its “unconditional liquidity” in the Fund. But in the following years when the Italian economy was strong, many countries drew lire from the Fund. The effect of each of these drawings was to increase Italy’s unconditional liquidity in the Fund. Thus, when adverse circumstances made it necessary for Italy to obtain Fund assistance early in 1964, it was able to draw, in various currencies, not $67 million, but $225 million, without going beyond the gold tranche.

These are some aspects of the mechanism through which the Fund has, since its beginning, been in the business of supplying its members with additional international reserves. I would ask you to bear this in mind when you hear it suggested that international agreements which lead to the creation of reserves are entirely novel operations. In 1965, Fund operations provided much the largest part of the in-
Liquidity and the Fund

Although the Fund's operations have been important in other years as well as 1965, the major additions to the world's liquidity since the war have come from gold production and the U.S. balance of payments deficit. These have in recent years been supplemented by credit facilities or arrangements outside the Fund which also contribute in no small degree to the sum of international liquidity. A well-known example is the network of standing currency-swap arrangements between the Federal Reserve Bank of New York and a number of central banks in other countries. Other examples include the ad hoc commitments of ten central banks to lend support to sterling.

The importance of the international payments position of the United States in recent years in relation to international liquidity can be explained as follows: If the United States has a deficit in its balance of payments, dollars come into the hands of central banks in other countries. The United States stands ready to convert these dollars into gold when requested by monetary authorities of other countries. In recent years, some of these dollars have been converted into gold, and some have been held as reserves by the recipient countries, depending on their policies and practices. Conversion into gold did not increase the total of international liquidity, since the United States lost the gold gained by the other countries. Increases in official dollar holdings outside the United States, however, provided net additions to the world's reserves. The sizable deficits which the United States incurred in recent years greatly increased the dollar holdings and thus the total reserves of other monetary authorities.

But obviously there are limits to this method of reserve creation. One limit is set by the conversions into gold to which I have referred, because they reduce U.S. gold reserves. Another limit is set by the fact that, as other countries' holdings of dollars rise and U.S. gold reserves fall, uncertainties may be caused which could give added stimulus to the desire of official holders of dollars to present them for gold. Moreover, such official dollar holdings might be augmented in consequence of the sale of dollars privately held by residents of other countries to their respective monetary authorities. So, far from adding to world liquidity, an excessive deficit by the United States could even lead to a contraction of liquidity, if it should produce sufficient concern about the dollar to cause a massive move to convert into gold. Simultaneously, the flow of newly mined gold into official monetary reserves could be expected to decrease as a result of heavy private buying.

As you know, there is broad agreement that it is not useful for the world or for the United States that the latter continue to run a balance of payments deficit, and U.S. authorities are committed to eliminating it. However useful these deficits may have been in the past, I would agree with the present consensus which discards the idea that it is the duty of the United States to run a deficit in order that world reserves may grow. The United States does not have a duty to run a deficit. Its duty is to maintain confidence in the soundness of the dollar. And the duty of seeing that world reserves are adequate rests with the world as a whole. This, in essence, is the "liquidity ques-
tion”: recent concern and discussions have, basically, been stimulated by the question of whether, as the United States brings its payments into balance, there will be enough world liquidity.

The Adequacy of Liquidity

This problem of the adequacy or inadequacy of international liquidity is fundamental. Unfortunately, it is also exceedingly elusive. It is theoretically possible that every country in the world, while pursuing its own national policies, would consistently find itself with balanced international accounts. In such a world, there would be no need for international reserves or liquidity; at most, there would be need for only a small seasonal supply. But in the real world, liquidity is needed, because countries are not always in payments balance, and frequently there are deficits by some countries that have to be financed. Furthermore, even countries which have balanced accounts need the assurance that, when and if a deficit is incurred, facilities will be available to finance that deficit over a period of time which will permit adjustments to be made with minimum threat to policies of economic growth. The larger the volume of world trade and international payments becomes, the larger are the imbalances which may reasonably be expected at any one time. There is therefore widespread agreement on the importance of maintaining an adequate level of liquidity in order to sustain the expansion in world trade and world economic growth. For a country like the United States, such an expansion is beneficial to its economy directly. The secondary consequences are no less important to the world as a whole. Healthy conditions in the industrial countries improve the markets for the raw materials which the developing countries export. Capital and aid for the developing countries are more likely to be forthcoming when economic conditions in the industrial nations are favorable.

But this area of agreement does not resolve the question of what is the adequate level of liquidity. International liquidity may be said to be adequate when it is not so scarce as to force countries to balance their accounts at the expense of stifling national and international growth, but, at the same time, when it is not so plentiful that countries can continue to run deficits without regard to the international consequences of those deficits in stimulating inflationary pressures abroad. It is not surprising that there are differing views on a question of such importance.

The Limits of Need

If there were a system that financed all payments deficits automatically—which would imply a virtually unlimited supply of unconditional liquidity—there would be no pressure on countries to deal effectively with their deficits. It is this that gives point to the emphasis on monetary discipline. There is wide agreement that any liquidity system must be based on a mechanism to bring deficits and surpluses back into balance—although there are differing emphases on this element of the system. Deficit countries should be under some pressure to put their houses in order. Therefore, the supply of liquidity should not be too abundant. Indeed, some countries in Europe are inclined to the view that there is too much rather than too little liquidity at the present time.

On the other hand, balance in international payments can also be restored by the surplus
countries taking steps to get rid of their surpluses. But, since payments deficits frequently flow from inadequate or misdirected policies, it is not surprising that surplus countries are inclined to stress the need for deficit countries to take adequate corrective measures. Where deficits do arise from unwise or ineffective policies, there is a good deal to be said for that view. But a surplus country also—especially if it restricts imports, or has a low level of economic activity, or does not encourage the outflow of capital—has a responsibility to share in the adjustment process.

There is, in fact, no statistical test that can be applied to determine beyond question whether any particular quantity of international liquidity is, or is not, sufficient. Some think that we have had too much, others that we have had too little. The problem is complicated in part by a natural tendency for any country to view the question from the viewpoint of its own economic position—to appraise, in other words, the question of world liquidity from its experience with its own national liquidity. It is further complicated by the fact that the normal diversity of economic developments will almost always supply evidence of some kind to support any of several views. On balance, we in the Fund tend to think that the amount of liquidity available in the recent past has probably been about right. If it had been too small, international trade could hardly have grown as it did in recent years, nor is it likely that countries would have achieved the growth in output or have maintained the high levels of employment which they have. If it had been too great, there would almost certainly be greater evidence of inflation in the world economy than there is at present.

But our concern must be for the future. As I have indicated, the elimination of the U.S. deficit will dry up an important source of new international liquidity. In my judgment, the really important issue for the longer run is whether arrangements can be made to ensure that the achievement and maintenance of a balance in the U.S. international accounts will not have harmful effects on the world economy. Without international action to create international reserves, this could well result in the adoption of contractionary or restrictive policies in other countries. This in turn could force the United States to take more severe measures to protect its balance of payments, and the result could be a downward deflationary spiral.

Recent Studies

This is the background for the recent liquidity studies of which you have heard. Such studies have continued in the Fund for several years, and we have been in close touch with studies being made by a group of industrial countries—the so-called Group of Ten—and by bodies of the United Nations.

There are many highly technical aspects of these studies which it would not be useful for me to discuss in detail today. I need only say that there are many possible ways in which new international liquidity could be created. Naturally, the position of gold, which is important in the international monetary system, has been carefully considered. The result of these considerations is that there is virtually no support, among the participants in the studies, for trying to solve the problem by a return to the old gold standard or an increase in the price of gold. Rather, attention is turning to
the advantages of techniques whereby additions to international liquidity could be periodically made on an agreed international basis. This can be done within the Fund or otherwise. But, as with most international questions, the matter of technique is secondary to obtaining agreement on the basic questions of policy.

**Future Problems**

We have now progressed to the point where the liquidity problem is better understood, and there is broad agreement on the need to find a satisfactory solution to it. In my view, differences of opinion as to the present adequacy of international liquidity should be no barrier to contingency planning in this complex field, so that, when and if action becomes necessary, the international community will be prepared to act. Among the issues to be determined are the following: (1) What are the world’s needs for reserves and prospects for their growth? (2) If a new reserve-creating mechanism is required, how wide should be the participation in that mechanism? (3) On what basis will the reserves be distributed? and (4) Who will control the decision-making process? These simple questions, however, are not conducive to simple answers. They involve complex technical, financial, economic, and political considerations.

Any scheme for reserve creation must start from the recognition of the legitimate reserve needs of developed and developing countries alike. The process by which decisions on liquidity creation are taken must also, in my opinion, be one that properly reflects the widespread character of the problem. The experience of the Fund, in which all members can exercise their proper influence, shows that this can be arranged in ways which at the same time recognize the special positions of certain countries.

The decisions that we are approaching refer not to the introduction of temporary improvisations but to basic further steps in the continuing evolution of the international monetary system. They will surely have a lasting influence on the future course of world economic developments, and thus on the economic position of each country. It is because of the international nature of the problem that a truly international solution is required. In the period immediately ahead, we shall be working very diligently on this question. I cannot now say when international agreement will be reached, or what the nature of the ultimate plans will be. But it seems clear to me that we are entering on a new era in the field of international monetary cooperation, and that, building on our past experience, we shall be able to provide a more solid foundation for the growth of international trade and the world economy, to the benefit of people in all countries.
Finland

From time to time, since the end of World War II, countries experiencing serious monetary difficulties have been able to solve them even after they had become critical. In this series of articles, members of the Fund staff concerned with such countries—and, as consultants to the governments, concerned with the countries' difficulties—describe the different circumstances in which this feat of stabilization was achieved and the methods used.

John Tvedt

Finland, lying at the periphery of the Western world, is in approximately the same latitude as Alaska, but westerly winds, warmed by the northern arm of the Gulf Stream, keep its climate moderate. Its well-educated population, totaling some four and a half million at the end of 1963, is largely concentrated in the South. Slightly less than a third of the working population is employed in agriculture and forestry, a little more than a third in industry and construction, and the remainder in commerce, transportation, and other service trades.

Its great forests are Finland's main natural resource and have provided the key to its economic development. In the nineteenth century, electric power and the machine-saw liberated the Finnish economy by permitting the establishment of paper and pulp mills. This development, coupled with technological advances in pulp and paper making and reductions in ocean freight rates, formed the basis for modern industrialization. Finland became a major exporter of forest products, and the earnings from those products made it possible to establish and develop other manufacturing industries. Between the two World Wars in particular, Finland was a model for any country moving from successful exploitation of a single primary product into a more extensive diversification of its economy.
Difficulties After World War II

In the first few years after World War II, however, Finland ran into economic difficulties. The cession of territories to the U.S.S.R. involved the loss of 9 per cent of the country's cultivated area, 11 per cent of its forests, and 11 per cent of its production facilities. The resettlement of nearly half a million Finns living in the ceded areas called for a land reform costing the equivalent of about $300 million. There were also war reparations, totaling $227 million in the period 1945-53, and heavy investments needed for reconstruction. Finland overcame all these handicaps—but at a price. Under the threat of serious inflation, the authorities had to impose strict control over prices and wages and introduce a system of subsidies on consumer goods. These measures were not wholly successful. They did not prevent large increases in costs; at the same time, they distorted the economy. In order to keep up an adequate flow of exports, the markka had to be devalued on several occasions.

Nevertheless, economic growth in the early postwar years was rapid. As early as 1947, production reached the prewar level; and in the following three years, it increased by a further 18 per cent. The rapid recovery of the economy was in part made possible by an inflow of foreign long-term capital which enabled Finland to finance an import surplus to supplement scarce domestic resources.

The year 1951 was a good one for Finland; the world market was favorable to Finnish exports, and the country's balance of payments improved considerably. But the next year was a difficult one. Because of the substantial amounts of foreign currency that had been available in 1951, Finnish importers had ordered large quantities of goods for delivery in 1952. In that year, however, Finland's exports declined, partly because of restrictions on timber purchases imposed by the British Government. When an economy depends very largely on a few products, a deterioration in export conditions is likely to affect the entire economy immediately. This happened in Finland; production stagnated, and unemployment increased sharply. Holdings of foreign exchange fell. Although reserves were much larger than at the end of 1950, they consisted mainly of currencies that were of little help in meeting current obligations.

To solve this payments problem, Finland made a drawing of $4.5 million on the Fund in December 1952. Further drawings, totaling $5 million, were made in January and May 1953, under the terms of a stand-by arrangement. At that time, stand-by arrangements were still new; this was the second such arrangement between the Fund and a member country. The deterioration in the balance of payments was short-lived. In the years after 1952, improved conditions in the major markets for Finnish exports and increased production capacity, together with the cessation of reparation payments, helped to enlarge the real resources of the country. In January 1955, all drawings on the Fund were fully repaid.

In the mid-1950's, however, the Finnish economy again ran into trouble. Production stagnated and the standard of living declined. Although there was also a slowing down in economic activity in several western countries,
which—as always—adversely affected the demand for Finnish exports, the difficulties at that time were due mainly to internal factors. Fiscal policy had weakened after 1954, and early in 1956 a large deficit in the government accounts began to show up. Measures were undertaken to restore equilibrium, but they proved inadequate. Although the rate of wage increases permitted under Finland’s incomes policy might have been in line with the rise in productivity, the prices and costs that emerged after any given increase tended to be above those abroad. A sharp increase in total money income in 1956 resulted in strong inflationary pressure. To finance the deficit in the balance of payments, Finland had to dig deeply into exchange reserves accumulated over the preceding three years.

In order to stop the deterioration, a decision was made in November 1956 to increase import restrictions. At the same time, the Governor of the Bank of Finland requested technical assistance from the Fund. To meet this request, two members of the Fund staff were made available to the Finnish authorities in November to discuss stabilization measures. These discussions were continued in January 1957 during the visit to Helsinki of a regular Fund consultations mission.

The Stabilization Program

Finland’s economic position in 1956 was serious enough to convince everyone concerned that action had to be taken to bring about stabilization and to improve the competitive ability that must form the basis of future economic progress. After the discussions with the Fund representatives, the Finnish Government drew up in 1957 a comprehensive program of economic reform to be carried out over a period of two years.

The program included a large number of fiscal measures, such as substantial increases in taxes and in prices of public utilities, and reductions in subsidies. These measures were supported by the Bank of Finland, which continued its efforts to prevent an inflationary expansion of private bank credit by increasing penalty rates for rediscounting.

The program, of course, depended heavily on success in restraining wage increases. Collective wage agreements, settling a 19-day general strike, had been signed in March 1956. They provided that the agreements could be terminated and wage negotiations reopened if the cost of living index should increase by a further five points, to 112. By August 1956, the five-point increase had occurred, but it was not until the late summer of 1957 that new agreements were signed. These agreements, roughly in line with the government recommendation, provided for only two-thirds compensation instead of full compensation for rises in the cost of living index; in any event, new wage adjustments would not be granted at all unless the cost of living index reached 130. Therefore, between March 1956 and the end of 1957 there were no significant wage increases.

The drastic fiscal measures and the wage agreement set the stage for a substantial improvement in the Finnish economy. But they were not by themselves—especially in the international economic climate of 1957-58—sufficient to alleviate the pressure on the balance of payments. This called for a severe reduction in imports, which could be brought

\[ \text{When the first of these new agreements was concluded, the index was 122.} \]
about quickly enough only by intensified restrictions. In March 1957, the Government instructed the Licensing Board to revise the import licensing system in such a way as to reduce imports from the Western countries by 25-30 per cent of their 1956 value. The Government was, however, alive to its international obligations; it attempted to avoid any increase in discrimination by making a major part of imports from these countries subject to global quotas. The program was made public at the end of March 1957 and was presented to the “Helsinki Club,” i.e., the Governments of Austria, Belgium, Denmark, France, the Federal Republic of Germany, Italy, the Netherlands, Norway, Sweden, Switzerland, and the United Kingdom. Negotiations were prolonged, and a multilateral agreement was not signed until July 25, 1957. It was made retroactive to April 1, 1957. The restrictions were maintained in their full severity for only a short period of time; thereafter, however, they were relaxed only gradually.

Because of the downward trend in demand for timber and timber products on world markets, and falling prices, action to bring about a realignment of Finnish and world market prices became unavoidable. Accordingly, with the concurrence of the Fund, the Government on September 15, 1957 devalued the markka by 28 per cent. At the same time, all multiple currency practices were abolished, and the Government instructed the Licensing Office to liberalize Finland’s trade with the West. Since a great increase in the amounts of markkas received for exports might have been inflationary, an export levy was introduced for a period of one year. After the devaluation, prices were frozen to the end of 1957, mainly in order to postpone an increase in wages.

Effects of the Program

Economic activity in most Western countries slowed down during 1957 and 1958, so that—unfortunately—Finland’s stabilization program had to be carried out under difficult international economic conditions. This makes it rather hard to distinguish the effects of the program from events that would have occurred in any event as a result of the international recession. To begin with, the reversal of the international business trend had only relatively small effects on the Finnish economy; exports of goods and services in 1957 were some 10 per cent higher than in 1956. In 1958, however, exports declined by 2 per cent, as Finland was harder hit by the international recession. Private investment, being decided upon in the light of current and prospective market conditions, also dropped, while public expenditures on goods and services increased at a much slower rate than in the preceding years. Because taxation (among other factors) was reducing incomes, private consumption and savings declined. As a result of the slowing down in domestic demand, internal activity stagnated, employment declined, and imports, which were affected also by the extension of import regulations during most of the year, fell by about 2.5 per cent.

Although the international recession continued throughout 1958, results of Finland’s stabilization program appeared more clearly in the course of the year. Domestic demand continued to slacken, but because of changes in relative prices brought about by the devaluation, a larger share of total demand was directed toward domestic production, and activity remained the same as in 1957. Despite import liberalization, the volume of imports declined sharply.

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By the middle of 1958, the full impact of the devaluation was felt in the price structure in Finland. It did not raise prices by quite as much as had been expected. This was due to declining prices of raw materials in the world market, keener price competition—brought about by the liberalization of imports—and weakening domestic demand. The price index of imports reached a peak during the first quarter of the year, when it was 25 per cent above the average of the third quarter of 1957. The wholesale price index rose by 11 per cent, but the cost of living index, under the influence of wage restraint, rose by a smaller amount. Not until February 1958 did it reach 130; then, in accordance with the collective wage agreements, wages were raised. For 1958 as a whole, nominal wages were about 4 per cent higher than the average for 1957. Since the increase in prices was greater, this meant a slight decline in real wages, which was unavoidable if Finnish export industries were to become more competitive in a hurry. That Finland’s competitiveness improved considerably there can be no doubt, since the country’s share of total sales in the major Western markets rose sharply during 1957–58.

The stabilization measures had an immediate and marked effect on the balance of payments. Despite a striking deterioration in the terms of trade in the first half of 1957, mainly brought about by an increase in prices of Finland’s imports, the current account of the balance of payments improved rapidly—from a deficit of $59 million in 1956 to a surplus of $76 million in 1958. As capital continued to flow in, foreign exchange reserves accumulated; from the devaluation on September 15, 1957 to the end of 1958, they increased by $160 million.

The Economy Transformed

The stabilization program—comprising a major fiscal reform, a substantial devaluation, and a radical change in the process of income determination—brought about a transformation of the Finnish economy by the end of 1958. Steps could then be taken to stimulate domestic demand, particularly investment demand. It was not until late 1958, however, when the international recession came to an end, that some signs of recovery appeared. In the following years, better conditions in Western countries, available capacity in Finnish industries, and improved conditions for Finland’s future industrial development brought about by increased competitiveness made it possible for Finland to increase its exports and to continue the economic progress which had been experienced until the setback of the mid-1950’s.

To say that Finland’s economic difficulties are over would, of course, be wrong. Indeed, there are signs now that developments in the last few years have again brought to the fore some of the difficulties that were evident, in much greater degree, in the mid-1950’s. Whether these can be overcome without the lengthy halt in economic growth which characterized the earlier difficulties will depend on the Finnish authorities’ success in preventing the erosion of Finnish competitiveness which alone can ensure the continued economic progress of this highly democratic republic.
What Does It Really Mean?

Multiple Currency Practices

Many countries in the last 30 years have experimented with "multiple currency practices," by which different kinds of international transactions are carried on at different rates of exchange. In this article these practices are explained, and the Fund's attitude toward them is outlined.

W. John R. Woodley

The Articles of Agreement of the Fund prescribe a system in which the international value of a currency (the "par value") is fixed in terms of gold, and no transaction in foreign exchange may differ from this rate by more than 1 per cent. But the system is not universal; many members of the Fund have separate exchange rates for different groups of exchange transactions—that is to say, they have resorted to "multiple currency practices." These practices may be quite simple; for example, in the Philippines until recently there was one exchange rate for major exports and a single free market rate for all other transactions. Or they may be very complex, as in Colombia, where the exchange rates range from about 9 pesos = US$1 to about 18 pesos = US$1. Simple or complex, multiple currency practices are widespread. Their traditional locus is Latin America, but they frequently occur in Asia and the Middle East and occasionally elsewhere as well.

But the Fund is opposed to them; their abolition and replacement by a unified exchange system is now, as it always has been, one of the Fund's objectives. The bias against multiple rates is based upon the lessons of history, drawn from exchange experience in the 1930's. During the depression years, multiple rates were used, particularly in Germany and in Latin America, as an export promotion device, and this led to retaliation by other countries and to a general environment of exchange instability and uncoordinated exchange.
rate policies. (For a description of these conditions, see Frank A. Southard, Jr., “International Financial Policy, 1920-44,” Finance and Development, Vol. II, No. 3, pp 135-43.) The Fund issued a general statement in 1947 to all its members, expressing its attitude toward multiple rates. Since that time it has made a number of general decisions, and in these, as well as in its Annual Reports and other public statements, it has urged countries to simplify complex exchange rate systems and to make a par value system effective.

Yet in spite of its general attitude, and its efforts to persuade countries that single exchange rates are in their interest, the Fund has approved multiple rate practices for many of its members. Frequently this approval has been on a temporary basis, and the Fund has remained in consultation with the member regarding the practice. Yet the paradox remains, and calls for explanation.

ARGUMENTS FOR MULTIPLE RATES

The following table sets out an imaginary, but fairly typical, multiple exchange rate system. In it, the “buying rates” are the prices that the monetary authorities in the country pay for foreign exchange earned by exporters and others; the “selling rates” are the rates at which the authorities sell foreign exchange, e.g., to importers.

In order to understand such a system of exchange rates, we need a reference point or norm. Such a reference point, here assumed to be P 7.00 = US$1, is the equilibrium exchange rate—a rate which would permit exchange receipts to finance exchange payments without excessive use of foreign exchange reserves, without undue reliance on restrictions on trade and payments, and without internal policies inconsistent with the relatively low degree of unemployment.

If a country moves away from such a rate, the effects would be similar to those of taxes or subsidies, as explained below. Governments do not necessarily object to this; on the contrary, taxing or subsidizing through the exchange system often appeals to them, particularly to the governments of less developed countries which find it difficult to implement effectively other tax and subsidy devices. Multiple rates have the advantage of being enforceable through the banking system where the officials who administer them are experienced in similar work. Moreover, the rates can usually be introduced and changed by the

### Exchange Rates

**(Pesos per U.S. dollar)**

<table>
<thead>
<tr>
<th>Buying Rates</th>
<th>Selling Rates</th>
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<tbody>
<tr>
<td><strong>Rates</strong></td>
<td><strong>Rates</strong></td>
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<tr>
<td>5.00 Coffee exports</td>
<td>6.00 Essential imports</td>
</tr>
<tr>
<td>7.00 Other major exports</td>
<td>8.00 Semiessential imports</td>
</tr>
<tr>
<td>10.00 (fluctuating market rate)</td>
<td>10.00 (fluctuating market rate)</td>
</tr>
<tr>
<td>Minor exports, invisibles (including capital)</td>
<td>Luxury imports, invisibles (including capital)</td>
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central bank, whereas a change in import or export taxes usually needs the approval of the legislature, which is not likely to be obtained quickly or easily.

The general way in which a multiple exchange rate system can be used to raise substantial amounts of tax revenue for the government will be apparent from the table. If the average price in local currency that the monetary authority (e.g., the central bank) pays for foreign exchange is less than the price at which it sells foreign exchange, it will make a profit in local currency which can be diverted to the government. For example, if the central bank pays P 5.00 for each dollar it buys from coffee exporters, and sells all these dollars to importers for P 8.00 or P 10.00 each, the profit will be handsome. There are, moreover, other advantages for a government in such a system of rates.

Exports

The case for taxes or subsidies varies with the commodity involved and the particular situation of the economy. In the table, the exchange rate of P 5.00 = US$1 for coffee exports involves a tax in two senses. Coffee exporters receive from the central bank P 2.00 less for each U.S. dollar they earn than they would receive under the equilibrium rate, i.e., the rate which notionally they would receive if there were no multiple exchange rate system in operation. More specifically, as the table shows, they receive fewer pesos for each dollar than do exporters of other major commodities. Governments may favor such a tax on several grounds. By giving exporters a less favorable rate of return, the tax may discourage the production of coffee. It may well pay the country to produce less coffee for higher prices. The tax may also be wanted because coffee growers are a relatively high-income group that may reasonably be called on to pay taxes. Another justification may be that the tax is easily collectible and productive of large amounts of revenue for economic development. Considerations like these underlie the penalty export rates for such products as coffee in Brazil and Colombia and wool and wool tops in Uruguay.

On the other hand, since commodities that sell for US$1 abroad would on average sell for P 7.00 in the imaginary country to which the table applies, exporters who receive P 10.00 for each dollar earned are being subsidized. Subsidies for certain exports—for example, the rate of P 10.00 = US$1 in the table—are advocated as a means of encouraging new industries, particularly those which process raw materials or develop nontraditional exports. One example of the encouragement of processing industries would be the use of the rate of P 10 = US$1 for exports of powdered coffee. By exporting powdered coffee, a businessman would earn (for each dollar received) twice the amount of local currency that he would earn by exporting unprocessed coffee. Obviously, he would have a powerful incentive for processing coffee beans into powdered coffee.

Countries that are themselves too dependent on exports of a few primary products which are subject to wide price fluctuations in international markets are eager to develop new export products; in those countries, special exchange rates (such as the P 10.00 rate in the table) may induce the development of new export products. They may even encourage industries that are currently producing for only the domestic market to expand their output.
and sell abroad; thus they may achieve the economies of large-scale production. Such considerations have influenced the granting of subsidy rates in the past to manufacturers in countries such as Colombia, Korea, Venezuela, and Yugoslavia, and they are important in Pakistan at the present time.

**Imports**

Similar considerations apply to the granting of special exchange rate treatment for imports. The import subsidy rate of P 6.00 = US$1 in the table might be used for particularly desirable imports—for example, raw materials or capital equipment needed to foster the expansion of local industry, or essential items in the diet of the lower income groups. Also, government purchases from abroad might be subsidized in this way in order to reduce the impact of foreign exchange expenditures on the budget. These factors were of particular importance in the Philippines prior to the exchange reform of 1959.

A tax rate for imports, such as the rate of P 10.00 = US$1 shown in the table, might be used to reduce imports of automobiles, Scotch whisky, and other luxury items regarded as undesirable in a poor country, or to increase the cost of imports competing with domestic production and thus to provide protection for domestic output. Argentina, Indonesia, Uruguay, and Yugoslavia have frequently used multiple rates for these purposes.

**Capital Controls and Revenue**

A number of countries, particularly in Latin America, have introduced into their multiple rate systems a special market for international movements of capital and other “invisibles” (international transactions which do not show up in customs returns; for example, personal services). Such a market now exists in Chile, Colombia, and Ecuador. In most countries having this special market, the exchange rate has been left free to fluctuate; as a result, the value of the local currency (in terms of foreign exchange) for these transactions has been less than its value for trade transactions. The market is justified as providing a “safety valve,” since both inflows and outflows of capital, which are usually more volatile than trade transactions, can occur without disturbing trading relations. If capital flight develops, the increased demand for foreign exchange in the capital market makes it more expensive to acquire exchange and so acts as a deterrent to sending funds out of the country.

**ARGUMENTS AGAINST**

Multiple exchange rates, then, have several functions that make them appear as an admirable weapon of government financial policy. However, the Fund’s long observation of the experiences of its members with such rates suggests the opposite conclusion. Multiple rate systems have, in practice, seldom operated effectively either to meet balance of payments problems or to provide the tax and subsidy effects desired by governments. Such systems have proved basically unstable, they have been difficult to administer, and they have frequently disguised problems rather than solved them.

**Exchange Rate Instability**

Most of the countries using complicated multiple rate systems have been subject to inflationary pressures and to a more or less rapid rise in domestic costs and prices. Such
Multiple Currency Practices

an environment greatly complicates any exchange policy, because the exchange rate has to be adjusted frequently to keep an appropriate relation between domestic and external costs and prices. The difficulties are particularly acute if multiple rates have been adopted for the purpose of providing taxation and subsidy. The underlying monetary instability continually disturbs the exchange system and destroys the function that the exchange rates are supposed to be serving. For example, many countries imposing tax rates on their principal exports, such as coffee, have found themselves paying out to producers, through price support or storage schemes, more than the amount of tax collected through the exchange system. Multiple rate systems designed to produce revenue for the government have sometimes in fact caused large government losses. In our imaginary example, this happens if the number of pesos that the monetary authority earns by selling dollars to importers is less than the number of pesos that the authority has paid to exporters to acquire the dollars. Such a situation occurs if the government, in response to inflationary pressures, depreciates the exchange rate for exports in order to keep them moving (e.g., alters it from P 5.00 = US$1 to P 8.00 = US$1), but does not adjust the exchange rate for imports. There may be a good reason for not adjusting the latter rate. Higher prices for imports could raise the cost of living; for example, to shift the exchange rate for imports from P 6.00 = US$1 to P 7.50 = US$1 would raise the wholesale price of imports by 25 per cent. One of the great drawbacks of multiple rates is that, once they are introduced, decisions about export and import rates can be taken separately. Virtually no one favors depreciation of the import rate (i.e., increasing the number of pesos that importers must pay for a dollar), even though its general effects might be highly advantageous for the long-term development of the economy. On the other hand, exporters are keenly interested in depreciating the export rate. Although problems like these are not inherent in multiple rate practices, these practices do frequently coincide with domestic inflation, and the danger of such difficulties is therefore considerable.

A further disadvantage of multiple exchange rates is that there is a high correlation between them and exchange instability. This is partly because the multiple rates are a response to payments difficulties and therefore are likely to require frequent adjustment, and partly because, if several rates of exchange exist, adjustment of one or a few of the rates is less difficult—because it has less widespread effects—than is a change in a unified exchange rate. (Adjustment of a unified rate always involves the government in a careful balancing of conflicting interests, since exporters and importers are then interested in the same rate. Exporters favor a more depreciated rate, to increase the local currency return from exports, while importers and local producers oppose depreciation because higher local currency costs will discourage sales and, at least in the short run, investment in capital equipment.) Now, instability in the exchange rate structure has inherent disadvantages. If exporters believe there is a likelihood that the export rate will be depreciated (changed in their favor), they will be tempted to withhold exports in the hope of securing better treatment. If their product is a major export and traders in this product act in concert, their speculative activities will do so much injury to the balance
of payments that it may force the government to allow the relevant exchange rate to depreciate, and thus reward the speculators. Similarly, unstable exchange rates for importers make local producers of competitive goods uncertain of the degree of protection they can count on if they should invest in expanding their plants or building new ones, and thus foster the development of the economy.

**Administrative Problems and Policy Dilemmas**

The administration of multiple rate practices is far from easy. First, to enforce multiple rates, exchange controls must be applied to segregate various types of transactions. In the illustration that we have been using, for example, exchange controls would have to be used to force coffee exporters to sell exchange at the P 5.00 = US$1 rate. The pressure to evade such controls would obviously be strong. And in addition to evasion, there will be strong political pressures to obtain more favorable exchange rate treatment. If some exporters are receiving P 7.00 for each U.S. dollar that they sell while others are receiving P 10.00, the former group will naturally make every effort to obtain equally favorable treatment; they may easily spend more time on this than on taking steps to improve efficiency of production or to sell more. Many countries have found that the more they differentiate their exchange rates, the greater is the pressure for further proliferation of the rates. This has sometimes resulted in an exchange rate manual as big as a large reference volume.

The use of multiple rates for imports also involves the government in a number of policy dilemmas. One of the apparently more valid arguments for very depreciated rates for luxury imports is that they discourage the import of these articles. These same exchange rates, however, provide abnormal protection for domestic industry and thus stimulate scarce local capital to invest in the production of the luxury goods that would otherwise be imported. A contrary disadvantage arises if favorable exchange rates are provided for imports of essentials. While this ensures their availability cheaply as imports, it means that there is little incentive to produce such goods domestically. The harmful effects of such low rates are accentuated if they apply (as they frequently do) to imports of foodstuffs; the consequential cheapening of food represses incomes and development in the farm community where incomes are normally the lowest, and fosters migration from the farms to the towns.

**Some International Implications**

The use of multiple rates by a country also has implications for the international community. To use one of the examples given above, a subsidy rate for exports of powdered coffee may achieve its purpose and result in a new industry producing powdered coffee. Such an industry may, however, injure the powdered coffee industry established in another country and lead the government of that country to protest, or even to take countermeasures. In the early 1950's, there was a lengthy international dispute over the use of different export rates for wool and wool tops in Uruguay, a number of governments arguing that the Uruguayan exchange system was destroying the wool top industries established in their countries. Changes in one exchange rate in a system of rates—for example, a more favorable rate provided for exports of cocoa—may lead other countries to protest that the country in-
Introducing this rate is seeking to obtain competitive advantages in the world market. The introduction of international commodity agreements for some commodities has meant that export rates have less effect on their sale; but the possibilities of competitive devaluation of exchange rates are still real and are of particular importance when a number of countries are trying to develop new exports. Another type of international difficulty may arise if a country grants a preferential exchange rate to imports from a second country in order to obtain preferred access to the markets of that country. In these circumstances, a third country that has export products competitive with those of the first may protest against the discrimination created by this special exchange rate because it effectively limits its own export marketing possibilities.

* * *

This outline of multiple currency practices indicates some of the many complex questions raised by a country resorting to more than one exchange rate. There have been occasions when the Fund has not entered objections to a proposal for a simple multiple rate scheme (i.e., a scheme with only two or three different rates) because the country was unable effectively to introduce a valid single rate. In such circumstances the Fund has been prepared to treat multiple exchange rates as temporary responses to presently insoluble problems, and has been willing to provide financial support to countries with multiple rates, including even fluctuating multiple rates. The Fund has found, however, that in most countries multiple rates sooner or later create as many problems as they solve and that such apparent solutions are seldom lasting ones. The aim of establishing a single rate that provides a uniform price incentive for export and import transactions is still a vital one for both the country concerned and the international community.
Africa and the European Economic Community

The agreement in principle reached by officials in July 1965 for a limited Nigerian "association" with the European Economic Community (EEC) emphasizes the importance of the relationship of African countries with the European Common Market and opens up new possibilities. Before the agreement, one half of the African states, eighteen in number, were associate members under the Yaoundé Convention of Association, with all the rights and obligations of the Convention, and one half were completely outside the framework of the EEC's Eurafrican arrangements. There was no intermediate status. Now, the pending agreement seems to offer a third choice.

Arnold Rivkin

THE AFRICAN relationship with the European Common Market began with the Treaty of Rome itself. This is the Treaty which, in 1957, created the European Economic Community (EEC) and provided for the initial association of the "overseas countries and territories" of the signatory states. Most of the "dependent overseas territories," 14, were in French Africa; 3 were in Belgian Africa; and one, the UN Trust Territory of Italian Somaliland, was under Italian jurisdiction. (There was also a scattering of Dutch and French holdings in America and in the Pacific area.)

The original association was arranged by the European powers, on the initiative of the French, on behalf of what were then their colonies. By 1962, the situation had altered drastically. All the associated African territories were by that time independent states. The new Convention of Association, which was agreed and initialed by the European Six and the African Eighteen on December 20, 1962, was arrived at only after hard and lengthy bargaining between the Six and the Eighteen. Whatever the nature of the original association, the current African association with the European Common Market is purely voluntary.

The Yaoundé Convention, which governs the new association, became effective on June 1, 1964 and is to run for five years. This opened the door to "association" much more widely—to any African state that might want to be "associated." It was this important "open door" policy that led to Nigeria's negotiations for association. However, the Nigerian agree-
African Countries Associated with the EEC
ment in principle will probably take a year or more from the date of the agreement to be incorporated in a final accord ratified by the EEC and the parliaments of those members of the European Six requiring such ratification. The agreement is to run through May 31, 1969, so that its time cycle can be coordinated with that of the Convention of Association of the Eighteen and the Six, and so that the whole subject of African association with the EEC, which takes on an important new dimension as a result of the pending Nigerian agreement, can, when the time comes, be reviewed in toto.

Trade Expansion

What the associated African countries gained from the Treaty of Rome was trade preference from the Six, and this, under the Yaoundé Convention, is what they keep. Under the Convention, certain products of the Associated African States—including cocoa beans, coconuts, coffee, pineapples, tea, unground cloves, unground nutmeg, unground pepper, and vanilla—are given immediate duty-free entry into the European Common Market. The same tropical commodities coming from nonassociated countries will have to surmount an EEC tariff. This may seem a bleak prospect for nonassociated countries; the Six have recognized this and brightened it considerably by reducing the tariff rates on the key tropical products, cocoa, coffee, and tea. In addition, as an outgrowth of the negotiations of the United Kingdom for membership in the EEC, duties on certain products—various tropical woods—were "temporarily suspended," and exports of these commodities from all countries enjoy duty-free entry into the Common Market area.

Thus, as part of a package deal, duty-free entry from the Associated States was accelerated, coming into force earlier than contemplated under the Treaty of Rome, and the rate of tariff protection on key commodities was lowered simultaneously. In a related move, the Associated States are, under the Yaoundé Convention and for the first time, receiving specific financial aid to increase their agricultural efficiency and improve their capacity to compete in world markets.

The exports listed above are not the only ones that benefit; there is to be a general progressive abolition of duties on tropical primary products and on manufactured goods originating in the Eighteen; the same commodities originating in nonassociated countries will be subject to a common external tariff.

The Associated States, for their part, are to reduce their tariffs on imports from the EEC by 15 per cent annually—in principle; in practice, the Associates will be allowed to maintain old tariffs or create new ones to protect infant industries or for revenue purposes.

Quota restrictions on imports, which the Community countries are in the course of removing among themselves, will be removed at the same rate for the Associated States. In return, no later than four years after the new Convention comes into force, the Associated African States are to abolish all the national quantitative restrictions on Community products (which have heretofore operated to favor the former colonial powers) and to replace them with quotas open to all the Community States without discrimination. This will, for example, facilitate the entry of equipment and machinery from the Federal Republic of Germany into former French West Africa. But
here again, as with tariff reduction, the Associated States' developing industries will be protected. And quotas may still be imposed for balance of payments purposes.

One characteristic is of great importance: the Convention is not exclusive of other arrangements. It does not prevent the maintenance or establishment of customs unions or free-trade areas between the Associated States, or between Associated States and other States, if such arrangements are in harmony with its own arrangements. There is nothing in the Convention that would prevent the creation of an African common market or markets.

How is Nigeria to fit into this framework? Most Nigerian exports will have free entry into the Common Market, but some of the most important, cocoa, peanut oil, palm oil, and plywood, will enter duty-free only in amounts equal to an average of the Six's imports of them over the three-year period 1962-64. These quotas are to increase by 3 per cent in

A market at Gombe, Nigeria

Association with the EEC may mean new outlets for Nigerian products
each year of the agreement. Imports in excess of the quotas will be subject to normal duties, ranging from 5 to 15 per cent. In return, Nigeria is to provide free entry, which will result in preferential treatment, for 26 exports of the Six to Nigeria, subject to the usual right to impose duties or quotas to protect infant industries or for revenue purposes. The goods in question represent a relatively unimportant percentage of Nigeria's total imports and of total exports from EEC countries to Nigeria—4 per cent and 8 per cent, respectively. Aside from impairing Nigeria's traditional nondiscriminatory trade policy, particularly vis-à-vis the United Kingdom (which accords Nigeria certain trade preferences under the Commonwealth trade arrangements) and the United States, the trade preferences are not expected to have a very far-reaching effect. There are no provisions requiring Nigeria to remove or reduce tariffs or quota restrictions on other EEC exports.

Economic and Social Development

One of the institutions created by the Treaty of Rome, the European Development Fund for Overseas Countries and Territories—generally referred to as the European Development Fund—has hitherto been administered by the Commission of the EEC. Under the Yaoundé Convention, the Commission will now administer the Fund “in cooperation” with a group, generally referred to as the European Development Fund Committee, of national representatives of the Governments of the Six. Moreover, a joint Council of Association of the EEC Commission, the Six, and the Eighteen shall “lay down the general pattern for financial and technical cooperation within the framework of association, more particularly in the light of the annual report to be submitted to it by the body responsible for administering the Community’s financial and technical aid.”

The Convention provides that over the five years of its life $800 million in assistance shall be provided to all the associated overseas countries and territories. Of the $800 million, $70 million is destined for non-African associated countries and territories. Of the remaining $730 million, destined for the Associated African States, $500 million is earmarked for economic and social development, investment, and technical assistance (which is now recognized as a specific type of assistance), and $230 million is earmarked to help the productivity and diversification of the agriculture of the African Associates, thus aiding them to make their way in world markets.

The $730 million of aid will come from two sources. Most of it, $666 million, will come directly from the Six. Of this latter amount, $620 million will be administered by the Development Fund in the form of grants (as the original funds of the Development Fund have been administered) and $46 million will be available for long-term “soft” loans, comparable to those of the International Development Association. The remaining $64 million of the $730 million total will be provided by the European Investment Bank (an institution created by the Six under the Treaty of Rome to finance investment within the European Community itself) from its own resources and will be administered by the Bank in an interesting new kind of “semisoft” loan. This type of loan will be for 25 years, at the prevailing rate of interest but with the possibility of arranging for “rebates” on interest payments of up to 3 per cent, with the Development Fund paying the amount rebated. Thus the Bank
still charges interest at the prevailing rate and
the borrowing country gets the advantage of a
reduced rate; at the same time, however, the
over-all total of grant funds is decreased. This
provision for subsidized interest rates is an in-
teresting forerunner of similar proposals dis-
cussed at the UN Conference on Trade and
Development (UNCTAD) in Geneva in 1964.

Under the Convention arrangements, the
African Eighteen will receive more grant aid
than they would under the Treaty of Rome.
Under the Treaty, which provides for a
total of $581 million of grant aid to the de-
pendent overseas countries and territories, at
least $35 million was destined for areas out-
side of the African Eighteen; in practice, how-
ever, it seems that some $70 million will flow
to these areas, leaving some $511 million for
Africa. By contrast, under the new Conven-
tion of Association, the African countries will
receive some $620 million in grants, as well
as $110 million in loans, for social and eco-
nomic development and agricultural productiv-
ity and diversification.

Technical cooperation or assistance is re-
ceiving a new emphasis and a new impetus.
Neither the Treaty of Rome nor the Imple-
menting Convention explicitly called for tech-
nical assistance for the Associates from the
European Development Fund or from the EEC
generally. But it was, in fact, provided. Both
the Development Fund and the EEC found
themselves more and more drawn into tech-
nical assistance ("t.a.") activities and increas-
ingly allocated funds for "t.a. projects" from
the regular Development Fund and from the
EEC's budget.

The special assistance to aid agricultural
efficiency and diversification has been divided
into two categories. The first, aid to produc-
tion, is essentially intended to assist producers
to market their products at world prices. The
second, aid for diversification, is to enable
the Associated African States to achieve this
aim not only in the primary agricultural sector
but in industry and commerce as well. It
seems likely to take the form of expanding
agricultural processing industries and impro-
ving the "commercialization" of raw and pro-
cessed agricultural commodities.

The agricultural aid of $230 million is to be
divided among three groups of countries:

$15 million for those countries which agreed
to meet world prices for their products
by the time the Convention came into
force—Gabon, Mauritania, and Upper
Volta. This aid will be for diversifica-
tion only.

$32 million for 4 countries already deemed
able to sell their products at competitive
prices on world markets—Burundi, the
Democratic Republic of Congo, Rwanda,
and Somalia. This aid will also be for
diversification only.

$183 million for the 11 remaining Associ-
ated States, whose price supports are to
be abolished only gradually. This aid will
be for both productivity and diversifica-
tion.

The aid is to be greatest at the start of the
five-year term of the Convention and to de-
crease gradually, as the Associates' prices be-
come more closely aligned with world market
prices. Pari passu, agricultural subsidies or
surprix given by individual members of the
EEC (particularly France) and by the EEC
itself to the Eighteen on imports from them
into the EEC area are to be eliminated.
Development assistance is thus an important element in the Yaoundé Convention. But Nigeria would get none of this; it would still stand outside this particular area of the Yaoundé framework. Under the Convention, any such assistance, had it been contemplated, could not have come out of the existing $730 million fund but would have had to be provided separately by the Six.

Investment

One of the main rights vis-à-vis their Associates that was given to the Six by the Treaty of Rome is the “right of establishment,” whereby nationals and companies of the Six are entitled to invest in and to establish commercial enterprises in the Eighteen on the same basis as nationals and companies of the former colonial power and on a basis as favorable as that on which any third country nationals may invest. Reciprocal rights are granted, under the Convention of Association, to nationals and companies of the Eighteen in the six EEC countries. These rights also provide that the movement of capital in connection with investment by the Six in the Eighteen is to be as liberal and nondiscriminatory as possible. For trade and other payments, the aim is the same.

In the pending Nigerian agreement, the provisions for investment by nationals and companies of the Six are essentially the same as those relating to investment in the Eighteen, but the provisions relating to the movement of capital are more restrictive.

The New Institutions

The Yaoundé agreement is administered by three new joint institutions—the Council of Association, assisted by an Association Committee; the Parliamentary Conference of the Association; and the Court of Arbitration of the Association.

The Council of Association, consisting of the members of the EEC Council of Ministers, the members of the EEC Commission, and a representative of the Government of each Associated State, will meet once a year, or more often if necessary. Its function is to establish the general lines of technical and financial cooperation and to survey the general operation of the Convention. Day-to-day administration will be handled by the Association Committee, consisting of one representative from each Community country, one representative from the EEC Commission, and one from each Associated State. In reaching formal decisions, the Six will have one vote, arrived at as the Six decide, and the Eighteen will have one vote, arrived at as the Eighteen decide.

The Parliamentary Conference, a joint body composed on a basis of parity of members of the European Parliament and members of the Parliaments of the Associated States, will meet once a year. The Council of Association will submit an annual report to the Conference. The Court of Arbitration will settle disputes on the interpretation or application of the Convention if the Council fails to agree.

Another departure which is not explicitly provided for, but in fact is probably as important as any of the official new institutions, is the direct access of the Eighteen to the EEC organs in Brussels. Following a precedent established by Togo on its accession to independence during the period of association under the Treaty of Rome, the Eighteen are now directly represented in Brussels by their own diplomatic missions to the EEC, speaking...
for themselves without the need of an inter-
mediary.

The pending Nigerian agreement does not provide for participation by Nigeria in these new joint institutions. Instead, it provides for a special EEC-Nigerian Council of Association and a joint secretariat to oversee the operations of the agreement. This participation in limited special institutions is in keeping with Nigeria’s announced policy toward the EEC as proclaimed by the then Minister of Finance: “We want trade relations with the minimum of institutional links.”

Some Conclusions

There can be little doubt about the advantages that the Eighteen Associated States derive from their relationship with the EEC. The desire of other African States to associate, but in new ways, suggests that they see the advantages very clearly and want to share them. At the same time, they would like to limit the scope and intimacy of the relationship, particularly its political implications, and also the exchange of benefits, even though this means sacrificing some of the advantages they might receive from full association, e.g., development aid. In the EEC family, these African States would rather be cousins than brothers.

And there can be little question about the importance of the precedent created by the agreement in principle between Nigeria and the EEC. It is likely to be influential, and even paramount, in the pending negotiations of the three East African countries (Uganda, Kenya, and Tanzania) and the three North African countries (Morocco, Algeria, and Tunisia) for associate status. The Nigerian arrangement is confined to trade arrangements, with Nigeria extending minimal privileges to the Six in return for preferential trade advantages in the European Common Market area. The special EEC-Nigerian institutions, although they appear to be somewhat analogous to those of the Eighteen and the Six, are likely to be little more than an annual review of the year’s operations. The Nigerian agreement may very well become the standard pattern of limited association for other African countries.

Clearly, there are serious implications for the original African Eighteen Associated States, flowing from the pending Nigerian agreement. It seems unlikely that they would wish to extend, or that the Six would require that they extend, over the long run, more rights, minor though these may be, to the Six than Nigeria will. Will the Eighteen, however, be able to retain their advantages over Nigeria with respect to trade, development assistance, subsidies, etc., if they are permitted to reduce the reciprocal preferences that they now extend to the Six?

The renewal or renegotiation of the Yaoundé Convention, due to expire in 1969, will be a turning point in the European relationship of the Eighteen and the Six and, beyond that, of Africa and the European Common Market. If present tendencies continue, it seems to the author that the Six might seek to disengage to some extent from the special, intimate Eurasfican relationship represented by the Treaty of Rome and the Yaoundé Convention. With—possibly—the partial exception of France, this is the direction in which they seem to be moving. The Five—it would seem to the author—would like to extricate themselves from the position of appearing to favor some African states over others, and at
the expense of others. They would also apparently like to extricate themselves from the necessity of contributing to the European Development Fund, confined to aid to the Eighteen, and, at the same time, to an additional series of roughly equivalent “compensatory” bilateral aid programs for the nonassociated African states. They would also probably wish to free themselves from the financial burden, actual or potential, of defraying the cost of subsidies to the Eighteen for agricultural output.

France itself seems to the author increasingly to have come to accept the position of its EEC partners as the logical concomitant of its desire to dilute its special commitment to the French-speaking African countries by expanding its relationship to other African states and beyond Africa to Latin America, the Middle East, and Southeast Asia. The Jeanneney Commission on French foreign aid policy certainly recommended just such a course of action. It recommended that France “widen the net of its foreign aid,” presumably by diluting its almost exclusive emphasis on aid to French-speaking Africa.

If the author’s speculations prove correct, then it seems likely that the relationship of the Eighteen with the Six will tend more and more to approximate the Nigerian pattern, with the progressive disappearance of special advantages except for a common African trade advantage, i.e., preferential access for a growing range of goods to the European Common Market, with few if any reciprocal concessions. This puts the African developing countries quite close to the position of beneficiaries of nonreciprocal trade preferences by developed countries—a position in which the developing countries at the UNCTAD Conference argued that they should all find themselves.

If all this comes to pass, it would mean a significant unfreezing of the existing pattern of Eurafrikan relationships. It would mean an important step in trade advantages for many, perhaps all, African states in the EEC area without significant reciprocal benefits to the Six. This in turn would, of course, create pressure on all developed countries to accord the same advantages to all African countries, and indeed to all developing countries. The future trade-and-aid relationship between Europe and Africa may not, after all, follow this pattern; but the Nigerian agreement, if ratified, will certainly be a turning point in this relationship.
Coordinating Aid to Developing Countries

Aid to developing countries is provided from many sources. The need for coordination in the granting of aid, the steps taken thus far toward this end (including the formation of the United Nations Development Program in January 1966), and the part played by the World Bank are discussed here.

David L. Gordon

The less developed countries of the world are assisted in their economic progress by resources received through a bewildering variety of channels, large and small. This diversity has considerable value, as it permits flexibility and experimentation and sometimes taps resources that might not otherwise be available. But it entails serious problems for both the givers and the recipients of aid. Most of the former have the formidable tasks of reviewing the economic performance of a large number of diverse developing countries, assessing the needs of these countries, and determining their capacity to service debts; also, they must judge the merits of projects proposed for the countries and decide on priorities.

Only a few of the largest aid-givers can maintain staffs, either at headquarters or in the field, of the size required to ensure that aid is used effectively. Others, lacking the staffs needed for widespread activities, may concentrate their efforts in a small number of countries or projects; thus they run the risk of appearing to discriminate arbitrarily. Different aid-givers may find themselves competing or working at cross purposes because they do not have information about assistance being granted by others. Also, lacking adequate data about a country, they may inadvertently encourage it to assume a much greater debt burden than it can safely carry.

Ultimately, of course, the national government of the country receiving external assistance has the responsibility for adapting that assistance to the country’s development purposes and needs. In some countries, the responsible ministry or planning agency is sophisticated and has had considerable experience in analyzing different offers of aid, selecting among them, justifying the country’s needs and plans, and negotiating terms. But in most developing countries, the economic administration is inexperienced. Everywhere it is overburdened, and its task is not made easier by the need for attending to repeated missions of politicians, economists, and aid administrators from the several centers of financial power. And the problems of fitting into a rational development program all the variables of aid
Finance and Development

received from many sources—differing preferences and criteria of the aid-givers, diverse types of equipment from various sources, widely varying prices, interest rates, amortization terms, and so on—are often overwhelming.

Finally, aid-giving governments are under a political necessity to assure, and demonstrate to their peoples, that the assistance being paid for by their taxpayers is being used as effectively as possible to foster economic progress. Likewise, the recipient governments have to provide similar assurances to their peoples, who will eventually have to make available counterpart resources in money and manpower and, in some cases, reimbursement—at least in part—of the aid received. Thus, there is increasing recognition of the need for informed and objective evaluation of the developing countries' programs, requirements, and use of aid—an evaluation that will carry real authority with the public at both ends of the aid pipeline.

As a result, more and more attention has been focused on the problem of "coordination" at two levels. One is concerned with global needs, problems, and conditions of aid and with "burden-sharing" among the aid-giving countries. The other is concerned with the needs and the use of assistance by the recipient countries. The two are obviously related, but I am here concerned primarily with the latter.

United Nations Technical Assistance

The first formal mechanisms for coordinating external assistance at the country level were set up in connection with the UN Expanded Program of Technical Assistance (EPTA). This program, currently running at about $66 million a year, includes the activities of 11 specialized agencies. Each of these

Aid to developing countries is provided through many channels:

World Bank and its affiliates, providing mainly capital financing but also considerable advisory and technical assistance;

International Monetary Fund, making available short-term financing, and technical assistance in fiscal and monetary matters;

Various United Nations agencies that provide technical assistance and relief—the specialized agencies in their several functional fields, the UN regional commissions and secretariats, the United Nations Children's Fund (UNICEF), the United Nations Development Program, the World Food Program, the United Nations Relief and Works Agency for Palestine Refugees in the Near East, other refugee agencies, etc.;

Regional financing institutions, such as the Inter-American Development Bank, the Central American Bank for Economic Integration, the European Development Fund, the European Investment Bank, the African Development Bank and its Asian counterpart now being organized;

Bilateral programs of "Western" and Soviet bloc industrial nations, of mainland China, and of a few other countries, such as Yugoslavia and Israel, which offer credits or grants and a wide range of technical assistance;

Contractors and suppliers offering equipment or services on credit, usually guaranteed to some extent by their national governments;

Private investors;

Foundations and private relief or missionary organizations; and so on.
agencies is largely autonomous; each has close ties with the national ministries or departments concerned with its particular functional specialty in its member countries; and many have their own programs in operation. The program proposals and claims on limited EPTA funds, put forward by each agency, have tended to reflect the inevitably parochial judgment of that agency, and its opposite numbers in national governments, as to the importance of their particular sector. The staff of the Technical Assistance Board (TAB) in New York, removed by thousands of miles and several administrative layers from firsthand knowledge of the situations in countries being aided, was until recently hardly in a position to judge the merits and priorities of the agencies’ proposals.

In late 1951/52, however, the TAB began to build up its network of field representatives, stationing Resident Representatives in countries or regions where technical assistance under TAB auspices was being provided on a substantial scale. The function of each Representative is to review technical assistance programs and projects proposed for his country by the several specialized agencies; to relate them to the country’s needs; and, in consultation with the national authorities, to put forward a technical assistance package designed to meet these needs within budgetary limits set by the headquarters of TAB in New York. He also reports to the Executive Chairman of the TAB on the progress of events and of the technical assistance program in his country; helps to resolve any problems that may arise in connection with the program; and provides administrative support to the technical assistance experts.

Following the creation of the UN Special Fund in 1961, to provide preinvestment assistance to developing countries, the Resident Representatives generally took on the additional duty of coordinating Special Fund programs in their countries. On January 1, 1966, the EPTA was formally merged with the Special Fund to form the UN Development Program; at that time, the two groups jointly had Resident Representatives in the field.

The responsibility of these Representatives covers only a fraction of the external assistance provided for economic development to the country in which they are resident. They have no voice in the allocation of resources provided by the various bilateral and private technical assistance programs nor by those of the World Bank or the International Monetary Fund (IMF). Nevertheless, through informal consultation with both providers and users of assistance from these other sources, they may be able to identify gaps or overlaps and either to modify the UN program or to suggest adjustments in the programs of others to correct the situation. They are not, of course, in a position to influence in any substantial way the aid provided for investment—which is far greater and involves more complex decisions and organizational problems, and larger political and commercial interests, than the programs of technical assistance.

Coordination of Investment Assistance

Partly because of these complications, measures for coordinating grants and credits for investment, provided from different sources, have evolved slowly. During the past year, however, the major aid-givers have given increasing attention to the need for such coordination.
The World Bank has defined the objectives of coordination measures as follows:

(a) to enable the recipient country and the several aid-giving governments and institutions interested in assisting that country jointly to consider its development program and needs in comprehensive, continuing fashion, rather than piecemeal, on the basis of competent, objective information and analysis;
(b) to facilitate the provision of external finance, technical assistance and advice from appropriate sources, and their efficient channelling to meet priority needs;
(c) to make it easier to adjust the character and terms of aid to the country's special circumstances;
(d) to reduce confusion and disparity of criteria and terms of aid from various sources, and duplication of effort in the presentation and review of programs and projects;
(e) to provide opportunities for mitigating the problems associated with aid-tying and suppliers' credits; and
(f) to help to highlight deficiencies or difficulties in the country's economic performance and to influence or assist the taking of remedial actions.

These are ambitious aims, and progress toward their attainment has so far been limited and spotty.

The first major initiative toward attaining coordination was taken in India, in 1958. In that year India, midway through its Second Five-Year Plan, confronted a serious balance of payments crisis. The World Bank convened a meeting of the principal creditor countries (United States, United Kingdom, Federal Republic of Germany, Canada, and Japan), with the IMF participating as observer. The ad hoc nature and purpose of the group were reflected in its original title, Meeting on India's Foreign Exchange Situation. But the participants soon recognized the value of continued consultation on development assistance to so important an aid recipient. Meetings of the Consortium, as it came to be called, were scheduled on a regular basis; and the group's membership was expanded to include Austria, Belgium, France, Italy, and the Netherlands. At the start of the Third Five-Year Plan in April-May 1961, the Consortium undertook a comprehensive review of the Plan's over-all foreign exchange requirements, and considered the additional amounts of aid which would have to be pledged for the first two years "in order both to provide immediate support for India's balance of payments and to enable India to proceed in an orderly manner with the placing of new overseas orders for the Third Plan." By June, the Consortium members had agreed to make available a total of $2,225 million of grants and long-term credits during these two years. Subsequent meetings, now usually held twice annually, have continued this pledging pattern.

A Consortium for Pakistan was organized in October 1960, two years after the initial Indian meeting, also under World Bank sponsorship. Its purpose from the start was to mobilize resources for Pakistan's economic development, on a long-term, continuing basis; and its membership and mode of operation are virtually identical with those of the Indian group. Frequently, the meetings of the two consortia follow one another immediately.

In subsequent years, there have been discussions of possible coordination machinery for several other countries. Those on Nigeria were the first to bear fruit, in the shape of something called a consultative group (CG), in April 1962. Other CG's have been organized for Colombia, the Sudan, and Tunisia—all, like that for Nigeria, sponsored by the World Bank—and for Ecuador under the auspices of the Inter-American Development
Bank. Consortia, based generally on the Indian and Pakistan models, have been formed by the Organization for Economic Cooperation and Development (OECD), to coordinate assistance to two of its members, Greece and Turkey. Membership in these groups varies somewhat. The United States, Canada, the major Western European aid-givers, and Japan are included in most of them; the World Bank, and the International Development Association are members of all of them; and the IMF participates as an observer.

In 1965, the World Bank, at the urging of a number of its member countries, undertook to broaden and intensify its coordination activity. It proposed to give first priority to strengthening the groups already in existence, especially those dealing with Africa. It also expressed readiness to sponsor new CG’s "where it seems likely that our efforts will be helpful and insofar as our staff resources and other commitments will permit."

Staff resources, indeed, constitute the crucial limitation, because the leadership of a CG requires elaborate preparation and sustained effort. The magnitude of the work load is suggested by the following summary of the responsibilities which the Bank considers it should be prepared to undertake in relation to a typical CG:

(a) making periodic comprehensive reports on the country's development possibilities, problems, and performances as a basis for the group's deliberations;

(b) commenting on the country's estimate of its aid requirements, making recommendations as to the types and terms of aid appropriate for it, and highlighting any problems arising from unduly burdensome debt accumulation;

(c) helping the recipient government to prepare or revise a development program, or advising on problems of execution, where such assistance is desired;

(d) assisting the government, as may be necessary and desired, in identifying projects, in their preliminary screening, in arranging for feasibility studies, etc., and in relating other technical assistance to the needs and priorities of the investment program;

(e) advising the government and group members as to the sectors and, where adequate feasibility studies exist, the projects that deserve priority for external financing.

The Bank proposed, therefore, to sponsor not more than five or six new CG's, at a maximum, during the fiscal year 1965/66. So far, it has committed itself in fact to undertaking these responsibilities for East Africa (comprising Kenya, Tanzania, and Uganda), Korea, Malaysia, Morocco, and Thailand, in addition to the groups established earlier. It has also expressed willingness, in principle, to take part in similar arrangements under the sponsorship of other international organizations, such as the Inter-American Development Bank.

Consultative Groups and Consortia

The essential difference between a consortium and a consultative group (CG) is that a consortium periodically undertakes a formal pledge, intended to provide for meeting an estimated investment or foreign exchange gap for the subsequent year (or perhaps two or more years in some cases), and then publicly announces the pledge. No such systematic pledging is called for in a CG. However, the group normally discusses the recipient country's needs and absorptive capacity for aid, and the sectors and projects that are appropriate for receiving external financing. Members of the group may indicate what commitments they are prepared to make.

It is not surprising that most developing countries would like the consortium approach—which results in explicit, publicized, advance
commitments of aid—to apply to them. And also it is not surprising that the aid-givers generally prefer the CG pattern; most of them strongly oppose the formation of any additional consortia. In fact, however, the difference is far less sharp than might appear. The pledges of the consortium take on real meaning only as specific objects and conditions of financing are agreed between the parties—and, even more, as funds are actually disbursed and goods delivered. However, the rhythm of project identification and appraisal, loan negotiation, the placing of orders, and the disbursement of funds usually has little relation to the rate of pledging. Unfortunately, the recipient country’s attention and efforts often tend to focus on the pledges rather than on the more meaningful (and less dramatic) process of getting them implemented; and when implementation lags, disillusionment results.

On the other hand, even without any advance pledge of financial aid, a CG, it is hoped, will encourage a larger and more assured flow of development resources to the country in question. This belief rests on three premises: first, that a CG relationship will increase the recipient country’s absorptive capacity, that is, its ability to make effective use of external aid; second, that the CG reports and discussions will enable its members to make a better assessment of the country’s needs and performance; and third, that in consequence the Group members will be more favorably disposed to respond to those needs and will find it politically and administratively easier to do so.

Fulfillment of these premises obviously requires a large measure of mutual confidence and good faith between the aid-givers and the recipient country. The consultative process that is envisaged must be a two-way street, in which the developing countries have effective opportunities to influence the attitude and decisions of individual aid-givers and lenders, as well as the other way round.

In this continuing, evolving relationship between aid-givers and recipients, the World Bank sees its role as that of information center for the CG members, and as guide, counselor, and friend to the developing country as well as an ardent advocate for the country’s legitimate needs and interests. The Bank would be engaged almost continuously in reviewing the country’s development program, consulting with the government on economic policies and measures, helping to identify and screen projects, bringing the more promising ones to the attention of the members of the consultative group, and checking on the effectiveness with which various development activities are carried out.

Relations with Other International Organizations

As has been suggested, the coordination of development aid is a matter of concern not only to the Bank and to the bilateral lenders and donors but also to certain other international organizations. Although the OECD has formed consortia for Turkey and Greece, it apparently does not intend to establish any formal machinery to deal specifically with other countries; however, its Development Assistance Committee (DAC) may from time to time review the effectiveness of coordination measures as part of its continuing concern with global aid policies and administration.

In Latin America, the Inter-American Committee for the Alliance for Progress (CIAP)
is charged with the responsibility of reviewing national development programs and recommending appropriate aid policies—functions that correspond in part to the coordination role envisaged by the World Bank. Special arrangements have been agreed by which any CG’s sponsored by the Bank in Latin America would be tied in with CIAP’s machinery and responsibilities.

Relations with the International Monetary Fund, of course, are especially close. A number of the key issues of economic policy and tests of performance with which CG’s are concerned are within the Fund’s sphere of primary responsibility, and the Bank relies heavily on the Fund’s analyses and judgments. The Fund has agreed to participate actively in all CG’s organized by the Bank.

Other agencies are also invited to participate—particularly the UN Development Program, whose technical assistance and preinvestment programs provide a most useful underpinning for the capital flowing from CG members. Close working relations will be maintained with the UN Resident Representatives in countries for which CG’s are established.

To sum up, the World Bank does not see coordination measures as a cure-all. A consultative group can, however, provide a framework in which the need for capital and the merits of economic policies and projects can be assessed more rationally and accurately than would otherwise be possible, and in which specific practical actions designed to further the shared development purposes of aid-givers and recipients can be discussed and, hopefully, agreed upon. It should have great potential value for improving both the psychological atmosphere and the operational efficiency of their collaboration. And the Bank has made clear its intention to devote its energies and staff resources, in increasing measure, toward realizing this potential.
Japan and Israel

Japan and Israel both have a record of rapid economic growth. What do these two very different countries have in common that contributes to their success?

Orville J. McDiarmid

The Great Economist Alfred Marshall warned that all economic generalizations are fallible; those about fast economic growth are perhaps even more fallible than others. Therefore, discretion is advisable when making generalizations based on observations of the growth process under particular circumstances. In this respect, economists are rather like the blind men of Hindustan whose observations, it will be recalled, were of limited validity in appraising the elephant as a whole, though fairly accurate for the particular portions of the beast with which they were individually in contact.

Thus we can hardly hope to draw lessons of universal validity from recent experience in Israel and Japan, the two frontrunners in the growth sweepstakes during the last decade. We may, however, identify some factors common to both countries which appear to have contributed to their success.

But even while we are looking for similarities, we see striking differences between these two countries, located at either extremity of Asia. Israel's area (about half that of Switzerland) is only about 6 per cent of Japan's, and her population is less than 3 per cent of the larger country's. About a third of Israel is arable with a water supply that is adequate at present; the mountains and cities of Japan leave only some 15 per cent of her area to be used for agriculture. Thus the pressure of population on the soil is roughly four times greater in Japan. Nevertheless, an outstanding feature of the recent history of both countries has been their successful application of mature and sophisticated techniques to scarce natural resources.

The Growth Achieved

A decade and a half ago, few predicted even a normal economic future for Japan and Israel. Official Washington certainly placed them both high on the list of "difficult" cases likely to require U.S. largesse for a long time to come. As late as 1952, Secretary of State Dulles observed, perhaps in a rare humorous vein, that suicide was not an illogical step for anyone concerned about Japan's economic future. To spread the laurels of prescience further, the World Bank, in 1955 and even later, was appraising Japan's total future creditworthiness at a figure much below what it now lends to that country in a single year. Israel
was not considered as a serious candidate for hard loans until after 1960. Even in retrospect, these judgments do not seem unreasonable, given the facts then available and the tendency that we all have to overlook the intangible elements in economic progress.

Yet the economies of both countries have grown more than 10 per cent a year during the last decade, Israel’s at a fairly steady rate and Japan’s at varying rates depending on the phase of her economic cycle. Japan’s greatest expansion took place in 1959-61, long after the prewar level of output was regained in 1952. In those three years, the annual growth rates were 14-18 per cent, compared with 7-14 per cent since 1961. Both countries enjoyed their most rapid growth when they were already well off by comparison with other developing countries. In 1954, Japan had a per capita gross national product (GNP) of $232 and Israel $745. Now these have grown to about $714 and $1,177, respectively.

Structural Features and Resources

Exceptional labor forces and strong entrepreneurship plus large inflows of capital are the assets most frequently cited as contributing to the economic growth of the two countries. The Japanese are undoubtedly exceptional among developing nations; their literacy and technical competence rank near the top. On the other hand, the labor force of Japan is not unique and does not explain why that country has far outdistanced the economic growth rates of the United States and of European countries, which have labor forces of at least comparable quality.

Israel’s problem of assimilating and retraining her labor force has been difficult and far reaching. About half of her immigrants (contributing about half of her population growth) have come from Africa, where the Jewish people were poorly educated and without experience in modern industry. While she has obtained highly capable technicians and professionals from Europe, many of them had to seek a livelihood in new ways, erstwhile professionals frequently joining agricultural communities. A common tradition combined with a strong sense of national purpose no doubt has helped to mold this heterogeneous population into an instrument for rapid economic growth. Also, for the new arrivals from Europe, the desire to regain a European standard of living (consumption has been increasing at a rate of more than 6 per cent a year) probably stimulated an all-out productive effort. In Japan, too, the effort to make up for the wartime losses in personal well-being has been an extra stimulus.

Both Japan and Israel have been able to draw on a substantial number of competent persons who were at or near the peak of their productive powers. Also, thanks largely to these new entrants to the labor force, the two countries enjoyed their most rapid economic growth when they had surplus or underutilized labor. This condition persisted in Japan up to 1960 and in Israel even later. Yet even when the supply of labor ceased to be abundant, there was no significant setback to the rate of growth of either country.

The limitations to the physical resources of Israel and Japan are very similar. Japan is almost completely dependent on imports for such vital materials as petroleum, ferrous and nonferrous ores, natural textile fibers, and rubber. Israel lacks nearly all industrial materials except some phosphates and potash.
extracted from the Dead Sea brine. Areas suitable for agriculture are limited in both countries. In fact, the growth records of Israel and Japan (and more recently of the even more overcrowded Taiwan) almost suggest the hypothesis that constraint on agricultural and primary industrial expansion is a precondition for rapid economic growth. There is no doubt that the transfer of labor resources from agriculture to industry has been associated with the increase in the productivity of labor in both industry and agriculture. Limitation of space has forced both countries along the difficult road toward high technical competence and managerial efficiency.

As for their environments, both Japan and Israel have been fortunate in being able to draw on new foreign techniques in a period of rapid technical change. Failure to recognize this potential was a principal cause of the misjudgments made immediately after World War II, when both countries did indeed seem to be at a disadvantage. Israel, cut off from contact with the outside world except by sea and air, subject to the Arab boycott, and outside all the world's preferential trading blocs, appeared ill-placed to compete. Japan seemed to be severely handicapped because of the loss of her former Asian territories, the trade restraints of the cold war, and the reluctance of many Western powers to admit Japanese products on a basis of parity. Some of these disadvantages have persisted.

Under these handicaps, the 5½-fold increase for Israel and the nearly 5-fold increase for Japan in the volume of their exports in the decade 1954-63 indicate their capacities to seek out and exploit their comparative advantages. Their rapid adaptation to new lines (light to heavy industry in Japan and cheaper to more expensive textiles, diamond cutting, and other labor-intensive products in Israel) and their maintenance of realistic export exchange rates (by a somewhat undervalued rate set in 1949, followed by conservative monetary and fiscal policies in Japan and several devaluations in Israel) were among the causes of this success.

Mobilization and Use of Resources

The immediate conditions for rapid economic growth in Japan and Israel have been the high commitment of total national resources to investment and a high return on this investment. Japan has invested a phenomenally high proportion of her GNP; investment averaged 39 per cent during the first five years of this decade, and rose to 44 per cent in 1961. Net capital imports contributed only a small portion of the resources required. Israel's investment rate has also been high, averaging about 30 per cent of GNP between 1960 and 1963. (These figures compare with less than 20 per cent for relatively fast growing economies, such as Pakistan.) However, in contrast to Japan, 50 per cent of Israel's investment resources came from abroad. It follows that Israel's gross savings have been comparatively modest, 10-12 per cent of GNP in the last few years. But the spread between the two countries' ratios of private savings to national income has not been great. Private savings in Japan have been about 28 per cent, and in Israel about 20 per cent, of national income. Because of the heavy expenditures for the settlement of immigrants, the Israeli Government has been unable to save. By comparison, about a third of Japan's savings has been generated in the public sector.
Areas suitable for agriculture are limited in both countries.

- farming on reclaimed land in Hokkaido, Japan
- a road through the Negev desert in Israel
Japan's progress, even up to the present, is widely thought to depend on the flow of grants and other transfers from her friends abroad. However, these have probably contributed more to consumption than to investment in recent years. In fact, while Israel's growth in the first decade or so of the State would have been impossible without liberal outside support, in recent years growth has been based largely on domestic savings and foreign borrowings on conventional terms. Neither in Israel nor in Japan can the continuing rapid progress of the economy be explained by the inflow of foreign capital.

Both countries have obtained a very high return on investment (their capital/output ratios have been between two and three), and the authorities have made sure that the private sector has had great freedom to invest. This freedom has led to a lower level of public investment than would have been desirable in the long run. The compensation has been in the growth achieved in the private sector.

What has accounted for this very efficient use of new capital investment? First, Israel and Japan have a great variety of industrial and agricultural establishments highly differentiated as to capital intensity and technology. The size of plant is well adjusted to the economics of the production process. Because of her small size, Israel, more than Japan, is a country of small-scale industry with more than 60 percent of the industrial labor force employed in plants of less than 100 workers. In both countries small industrial establishments apply large amounts of highly skilled labor to inexpensive machinery.

The second factor that has contributed to the favorable capital/output ratio is also structural. The capital stock of both countries is relatively "new" and has been used very flexibly. Entrepreneurs have diverted corporate savings (or communal savings of the Israeli Kibbutzim) from lines with little promise to those giving greater hope for profits. The Japanese shift from textiles to light industry to heavy industry all in the space of a few years, and the Israeli shift from agriculture to light but high-quality industrial products, illustrate this. The recent change in the direction of Israeli investment is the more remarkable because during the 1950's agriculture was growing faster than the rest of the economy (agriculture's contribution to GNP grew from 8.6 per cent to 12.7 per cent).

With the approaching labor shortage, both Japan and Israel are using labor more economically in industry and agriculture. In Israel, from 1958 to 1963, capital stock per worker in agriculture increased by 83.8 per cent and in industry by 41.2 per cent. In Japan, from 1957 to 1961, fixed capital investment per worker increased by 7.6 per cent a year, compared with 3.4 per cent a year from 1951 to 1957. Over the three years 1961-63, output per worker in manufacturing increased by 24 per cent in Japan, compared with only about 11 per cent in the United States.

Institutional Factors

Both the Israeli and Japanese people have an extraordinary capacity for improvising institutions conducive to economic development at the particular time they are needed. However, these institutions do not include a strong central planning system. There is relatively little effort made at detailed planning of the private sector. In Israel, the "private" sector includes the powerful National Labor Federation, or Histadrut, which not only strongly influences labor policy for the country as a whole but owns a large segment of Israeli in-
industry and, through the Kibbutzim and Moshavim (cooperatives), has large agricultural interests. The Histadrut and its affiliates have performed a useful function in the field of collective saving and capital formation, particularly in the early years of the State. The cooperative system is also extremely strong in Israel, as it has long been in Japan. Thus collective elements are influential in the private sector.

These institutions have helped their countries to develop along essentially capitalistic lines without a capital market considered efficient by U.S. or European standards. In both countries, private savings are mobilized to a very large extent by and through the commercial banking mechanism, and the relations between banks and industries are very close. From their experience, it is difficult to contend that a broadly based capital market with a wide diffusion of equity ownership is necessary for rapid economic growth.

The experience of Israel suggests that financial stability achieved by orthodox fiscal and monetary policies may not always be a necessary precondition to sustained economic growth. To a much lesser extent, this is true of Japan, which has experienced substantial fluctuations in monetary stability. Japan's fiscal policy has been conservative since Occupation times, and little recourse has been made to either the banking system or the money market to finance public expenditures. On the other hand, commercial bank credit to the private sector has increased considerably faster than the growth of the economy. Money supply increased from about 26 per cent of gross national expenditure at the beginning of 1961 to more than 32 per cent in 1963, despite the fact that in 1962 Japan was experiencing one of its well-known liquidity crises, when a “tight money” policy is used to correct an adverse balance of payments. The vigorous growth in the productivity of Japan’s manufacturing sector has restrained the impact of monetary expansion on wholesale prices over the years, despite considerable year-to-year fluctuations. However, consumer prices rose about 40 per cent during the decade following the Korean war. The relatively inefficient distribution sector, combined with rising costs of food, explains part of the striking divergence between wholesale and retail price trends.

Israel has followed a much less orthodox course. Monetary expansion has been kept within the bounds of the real growth of the economy in only a few years; and in recent years it has been two or three times that growth. As in Japan, bank credit to the private sector has been the dominant factor, though the financing of government deficits has also been important. Particularly in the last few years, large net inflows of foreign exchange have produced inflationary pressures.

For better or for worse, Israel has played a pioneering role in “accommodating” herself to the problems of a growth cum inflation economy by linking the wage and debt structure to the consumer price index and/or to the exchange rate. The exchange rate, in turn, has been adjusted whenever domestic prices and wages have threatened to drive the current account deficit above the net inflow of capital. These linkage arrangements have been viewed with consternation by the orthodox, since, like so many palliatives, they tend to perpetuate the ailment they are designed to relieve. However, they have reduced the distortions and inequities that otherwise would have flowed from long-sustained inflationary pressures.

The fiscal and monetary management in both countries has not handicapped the growth
process, though in Japan at least it has made it more jerky than perhaps it needed to be. One would be hard pressed to maintain that a lesser response to the underlying demand for credit would have produced more economic growth. The fact that the spigot had to be turned halfway off from time to time seems only to have whetted the thirst of the business community for another long draught of credit when the balance of payments was restored to health, or whatever other malaise was brought under control.

Neither country has a genuinely free labor market. Insofar as wage determination is concerned, the restraints on market forces are greater than those to be found in most free enterprise economies with trade unions and collective bargaining. In Israel, in addition to the fact that the results of the periodic wage negotiations between the Histadrut and the Manufacturers’ Association are accepted as the bases for wage adjustments throughout the economy, the linkage between wages and the cost of living further limits the scope of wage flexibility. In Japan, while the labor movement is highly fragmented, the traditional stratification of the wage structure by age groups, and the custom of lifetime adherence to a single employer, also reduce the adjustment of wages to economic change. In both countries, however, the growing shortage of young skilled labor is imparting more and more flexibility to wage agreements. While real wages have been rising in both countries, they have lagged behind increases in productivity.

The Future

What of the future? Lack of water is probably the most important hindrance to future economic growth in Israel. Only a massive technological breakthrough in desalinization can remove this constraint. Israeli agricultural production, after a decade of rapid growth, may have to be stabilized after another five years or so. No such physical limitation applies in Japan.

Some time, perhaps a decade hence, a labor shortage may be a constraint on the economic growth of both these countries, though this cannot now be predicted with any assurance. Japan, of course, looks only within its own border for its labor, while Israel looks both within and without. Thus the latter’s situation may be regarded as the more hazardous. The age structures of the population of both countries are still very favorable to high productivity. In Japan, two thirds of the population is between 15 and 64 and the working age is being extended because of greater longevity. Fuller utilization of the capacities of older workers is one basis for believing that labor shortage will prove to be less important than it now appears to be. Today, dual employment is common in both Israel and Japan (one third of the male agricultural workers in Israel are also in nonagricultural pursuits).

It would be unwise to predict that shortage of capital is likely to limit economic growth in either country in the near future. However, both countries have problems. Japan’s is to maintain her phenomenally high savings rate in the face of all the enticing consumer items her factories are turning out. Israel’s is that of replacing by domestic savings the reduction in net capital inflow that seems certain to occur a few years hence. Neither task should be beyond the capacity of these two countries that have accomplished so much against much higher odds than they now face. Adaptability has been possibly their greatest advantage, and neither country is likely to lose it.

In this book, Lauchlin Currie offers refreshing views on what he regards as the basic obstacles to development and how they may best be tackled. His analysis stems from long and intimate experience with Colombia. This is not the first time that this country has inspired a new look at the general problem of development.

The main merit of the book is the forceful way in which it directs attention to some of the crucial links in the development process: the increase in agricultural productivity, the flow of labor into the towns and into industry, and the productive utilization of these new arrivals in the urban economy. Currie calls for a thorough reorientation of development expenditure and policies, stressing in particular the mobility of labor, housing and urban services, and the utilization of existing industrial capacity. A clear statement of development orientation is welcome—too many “plans” are merely macro-economic projections or an assembly of isolated projects, in neither case adding up to a development policy. Currie’s emphasis on expenditure on the towns fits neatly into a plan for absorbing rural workers, and one can hardly argue that this expenditure will not gain in importance in the wake of the heavy infrastructure spending of the past decade. But the book lacks a serious attempt to estimate the cost—in real and financial terms—of the recommended social-urban investment program. Without such estimates we cannot translate Currie’s reorientation into a workable plan or even begin to tackle the basic issue of the priority of these expenditures relative to investment in manufacturing industry, power, and transportation.

The book is in step with the emerging emphasis on a concerted approach to development planning and finance—both nationally and internationally (although, like others in Latin America, Currie overdraws the parallel with the Marshall Plan). It is new in its basic approach of analyzing the causes of low productivity and exploring ways in which these causes may be attacked directly. In his search, the author feels the need to evolve concepts and methods of analysis and measurement tailored to the problem of growth in developing countries rather than to the problem of employment and production in industrial economies. As he puts it: “What started out in the hands of Keynes as a useful set of definitions and concepts to explain inflation, or the persistence of unemployment, or the emergence of a brake on a recovery movement, is in danger of becoming a mental straitjacket on our thinking about development problems.”

I heartily commend this book. The reader will find it hard to put it down once he has started it.

Barend A. de Vries

There is widespread, though not universal, agreement that the international monetary system is passing through a period of difficulty and that the time has come for the introduction of basic reforms. There is little agreement, however, about either the nature of the problems which the system is facing or the solutions that must be found for them. Various plans for international monetary reform have been advanced from time to time. Some of them differ from one another in their technical details while the differences among others present fundamental differences in views about the basic nature of the problems which need to be solved. It is useful, therefore, to have some guide through the plans. Since the various plans are not equally accessible, it is useful also to have a single publication in which the major plans have been brought together.

Hawkins has arranged in three groups the various plans included in his *Compendium*. The original Keynes Plan, the Triffin Plan, the Angell Plan, and the Stamp Plan are presented in Part I. The proposals put forward by Lutz for a multiple reserve currency system, the Bernstein C.R.U. proposal, and the Roosa Plan are presented in Part II. The views on the subject of international monetary reform expressed by the International Monetary Fund in its 1965 Annual Report, and those of the Joint Economic Committee of the U.S. Congress given in *Guidelines for Improving the International Monetary System*, are presented in Part III.

The *Critical Survey* goes much further than the *Compendium* because it not merely examines the plans included in the *Compendium* but also discusses other proposals: those involving a return to the gold standard, those calling for some kind of break with gold, and those suggesting the introduction of flexible exchange rates. In each case, the merits and demerits of the proposal are outlined. The authors take particular care to show the nature of the problem that each solution reflects. They have also been able to compare the various proposals briefly with one another. The two volumes must, therefore, be considered extremely useful. As new variants of these schemes are still being introduced, and it could hardly be expected that all the plans could be thoroughly examined within the brief compass of 80 pages, the volumes under review should be considered introductory in nature.

Hannan Ezekiel


This volume presents an up-to-date account of Pakistan’s trade and payments, banking and public finance, and plans for economic growth. One author, Mr. Mohammed, is a member of the Fund staff; the other, Mr. Andrus, is a member of the U.S. Agency for International Development.

DURING THE PAST DECADE, the role of education in national development has commanded increasing attention from three principal sources. Economists have begun to study such neglected subjects as the economic return of education, residual factors in economic growth, manpower and human resources, and, more recently, the financial implications of educational expansion. Agencies financing development have realized that investment in physical development may be disappointing, owing to lack of essential human skills and attitudes. Finally, political leaders in the developing countries have had to respond to the surging demand of their people for education at all levels.

New strategies of educational development—more closely related to economic needs and possibilities and at the same time taking account of political realities—are now being worked out. Cerych's brief but well informed and thoughtful study, aimed principally at the problems of aid-giving agencies, is a valuable contribution to these efforts, useful to specialists and nonspecialists alike.

Over the past five to ten years, Cerych points out, school enrollments and educational expenditures in the developing world have increased by approximately 10 per cent per annum, while the rate of growth of gross national product (GNP) has been about 4 per cent. Most developing countries are probably spending 4 per cent of GNP and allocating over 20 per cent of public expenditure for education—figures approaching those of the developed countries while still falling far short of what is needed for educational services. The "squeeze" produced by these disparate rates of growth calls for careful planning and no waste, the more so since capital expenditure in education involves a high rate of commitment to recurrent expenditure. A bad choice now not only wastes resources; it seriously restricts the range of choice in the future.

The book offers a number of useful guidelines on how external aid for education might be applied most fruitfully. Generally, Cerych holds, the higher the level of education the greater the scope and justification for external assistance and the greater the multiplier effect.

He also offers some sound warnings against oversimplified formulae relating to the form and content of education for economic growth, and emphasizes the importance of the distinction between trained people and those capable of being trained. Where possible, training should be done on the job or in close relation to the employer. The major task of the educational system is to supply the economy with people who are trainable. Therefore, he asserts, "The crux of the matter is not so much to create more technical schools but to increase science and technical teaching in the general schools."

Cerych covers perceptively a wide range of other topics, including the sources of aid, the forms of aid (grants versus loans), and the problems of coordination among aid agencies. In referring to the entry of the World Bank Group into this field, for example, he recognizes
that it is not simply the adding of another source of funds but a significant innovation in method: "The fact that this institution, which normally applies methods based on the concepts of classical banking economics, allotted over 18 months a total of $22.6 million of loans . . . for education, seems to be one of the major innovations, indeed almost a revolution, in the policy of international economic relations over the last fifteen years."

Duncan S. Ballantine


Twelve Essays on five mid-African countries—Ghana, Kenya, Nigeria, Tanganyika, and Uganda—are collected in *Financing African Development*. The authors, all recent graduates from Harvard University or the Massachusetts Institute of Technology (M.I.T.), had, as M.I.T. Fellows in Africa, worked for two years as civil servants in African government agencies.

Four of the essays are concerned with the financial planning of economic development, seven with private investment, and one with foreign aid. The second group of essays should be of particular interest to African planners concerned with devising policies and institutions to generate external funds and local savings to satisfy the capital needs of new and expanding private firms. In "Promoting Private Investment in Less Developed Countries," Scott Spangler describes the main features of Ghana’s legislation for this purpose and indicates what he considers to be its shortcomings. He points out that the mere existence of tax concession laws is no guarantee that the necessary directives have been issued to carry them out; for such laws to be effective, a permanent executive agency with a capable staff is required. He further suggests, citing experience in Puerto Rico, that in order to attract private foreign finance the rate of return may have to be in the range of 20-30 per cent, rather than the 8-9 per cent usually considered adequate by most tax concession legislation. In "Legal Safeguards for Foreign Investment," Jonathan Mallamud pursues this theme further and argues that a public policy which is consistently well disposed toward private foreign investment makes many tax concession laws superfluous. Both Mallamud and Spangler are aware that determined governments can usually find the means, with or without tax holiday laws, to offer significant financial benefits to desired investments.

Curiously, as the literature on tax concessions for foreign investors continues to expand, relatively little attention has been given to the developing countries’ efforts to generate internal savings and to channel these funds through private capital markets to local productive investments. Douglas Gustafson’s "The Development of Nigeria’s Stock Exchange" is an effort to redress the balance. After a concise history of four successful private capital issues in Nigeria, Gustafson discusses the need for an exchange mechanism and relates the steps taken to organize a private stock exchange in Lagos for trading government stock and

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private securities. He considers that the early operations of the Lagos Stock Exchange were encouraging and that the yields on a number of private issues were attracting the interest of both institutional and individual investors. He deals briefly with the problems of operating an exchange in a relatively thin market and discusses what might be done to assist a small stock-exchange in its formative years. This is an interesting and important pioneer study.

Another recent book, the *Oxford Regional Economic Atlas of Africa*, will be indispensable to African regional planners. Subject maps (60 pages) of the African continent dealing with such topics as soils, temperature, rainfall, natural resources, transportation, commodities, and population distribution follow 43 pages of detailed topographical maps. The value of the excellent cartography and index is but slightly diminished by the fact that the statistics used throughout 52 pages of economic comment are outdated.

August T. Schumacher
Recent Activity

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

Tenth Anniversary of EDI

JANUARY marked the tenth anniversary of the Economic Development Institute (EDI), the World Bank staff college for senior officials of developing countries who are directly concerned with economic development. The EDI began as an experiment to determine whether the experience of the World Bank in dealing with problems of economic development in many countries could be used to broaden the perspective and competence of senior officials of such countries. The Institute is now a firmly established part of the World Bank's activities. It has, since its inception, increased the number of courses it offers senior officials from one each year to as many as six in a 12 month period. As well as increasing the intensity of its program, the Institute has diversified: it now offers courses in three languages (English, French, and Spanish), and expanding from its basic six-month general development course, it has entered the field of project evaluation. It now provides courses in industrial, agricultural, and general projects.

Multilateral Investment Guarantees

During the March 1966 quarter, Executive Directors of the Bank began discussions on possible Bank sponsorship of a scheme designed to guarantee private foreign investment in developing countries against loss from noncommercial "political" risks, thus encouraging the flow of private capital funds and know-how into developing countries. The risks covered by the scheme might include expropriation, restrictions on ability to convert and transfer principal and earnings, and war. The United States, the Federal Republic of Germany, and Japan for some years have offered protection against these risks to investments made by their own nationals; and in 1964 the UN Conference on Trade and Development asked the Bank to study ways in which this type of national scheme could be extended internationally. Coincidentally, the Council of the Organization for Economic Cooperation and Development was preparing a report outlining the principal features of a possible international guarantee scheme. This report has been the starting point for discussions about the proposal within the Bank.

Convention on Settlement of Investment Disputes

In another sphere, World Bank action to improve the climate for the flow of private capital continued to receive support during the quarter. This is the Bank-sponsored Conven-
tion on the Settlement of Investment Disputes between States and Nationals of Other States.¹ It provides for the establishment of an international center for settlement of investment disputes, which will operate as an autonomous institution under Bank auspices and offer contracting states the facilities of both conciliation and arbitration for the settlement of disputes. The Convention will enter into force 30 days after it has been both signed and ratified by 20 governments. At the end of March, 35 Bank member countries had signed the Convention, but only 4 members had ratified it: the Central African Republic, Ivory Coast, Mauritania, and Nigeria.

New Bond Issues

During the quarter the Bank carried out three successful funding operations. In the first of these it arranged to refinance on February 1, 1966, the date on which they matured, notes totaling $22 million and DM 40 million (US$10 million) by issuing in exchange new notes totaling $16 million and DM 64 million (US$16 million) maturing on February 1, 1968 and February 1, 1971 with interest at 4 7/8 per cent. In the second operation, on February 14, the Bank launched in Canada a new cash issue of Can $20 million of 5 3/4 per cent 25-year Canadian dollar bonds. The new issue, which will mature on March 15, 1991, was offered at 97 and accrued interest, to yield 5.98 per cent. The issue—which was oversubscribed—was the World Bank’s fifth offering of its bonds in Canada. The last issue was in February 1965. In the third funding operation for the quarter, the Bank announced on March 16 that it had arranged the sale, entirely outside the United States, of a $100 million issue of U.S. dollar bonds. The sale, at par, was made by private placement with central banks and other governmental institutions in 22 countries and with one international organization. The new bonds, known as the Two-Year Bonds of 1966, bear interest at 5 1/4 per cent payable semiannually, with the first payment due September 15, 1966. The issue, dated March 15, 1966, will mature March 15, 1968.

New Development in Loan Pattern

On March 30 the Bank announced the first loan it has made exclusively for engineering services connected with a proposed project. This was a loan of $1.7 million to finance engineering services required by the Republic of Guinea to enable that country to obtain firmly based estimates of the construction costs of a railway, port, and township which the Government proposes to build in order to develop the country’s rich bauxite deposits. These deposits, in the Boké region of northwestern Guinea, are considered among the most abundant in the world.

**WORLD BANK LOANS DURING THE FIRST QUARTER OF 1966**

<table>
<thead>
<tr>
<th>Country</th>
<th>Purpose</th>
<th>Amount ($ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>Electric Power</td>
<td>49.00</td>
</tr>
<tr>
<td>Guinea</td>
<td>Engineering Survey</td>
<td>1.70</td>
</tr>
</tbody>
</table>

Loans made during the first quarter of 1966: 50.70
Total Bank loans made during the calendar year 1965: 1,167.20

**IDA CREDITS DURING THE FIRST QUARTER OF 1966**

<table>
<thead>
<tr>
<th>Country</th>
<th>Purpose</th>
<th>Amount ($ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basutoland</td>
<td>Roads</td>
<td>4.10</td>
</tr>
<tr>
<td>Burundi</td>
<td>Water Supply</td>
<td>1.10</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>Education</td>
<td>7.20</td>
</tr>
<tr>
<td>Pakistan</td>
<td>Agriculture</td>
<td>19.20</td>
</tr>
<tr>
<td>Pakistan</td>
<td>Industry</td>
<td>25.00</td>
</tr>
<tr>
<td>Tanzania</td>
<td>Agriculture</td>
<td>5.00</td>
</tr>
</tbody>
</table>

Credits extended during first quarter of 1966: 61.60
Total IDA credits extended during the calendar year 1965: 196.20

**IFC INVESTMENTS ANNOUNCED DURING THE FIRST QUARTER OF 1966**

<table>
<thead>
<tr>
<th>Country</th>
<th>Type of Project</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ethiopia</td>
<td>Pulp and Paper</td>
<td>$1,900,000</td>
</tr>
<tr>
<td>Greece</td>
<td>Cement</td>
<td>3,500,000</td>
</tr>
<tr>
<td>Malaysia</td>
<td>Cement</td>
<td>1,559,200</td>
</tr>
<tr>
<td>Mexico</td>
<td>Construction Equipment</td>
<td>360,288</td>
</tr>
<tr>
<td>Venezuela</td>
<td>Can Production</td>
<td>514,541</td>
</tr>
</tbody>
</table>

Investments announced during the first quarter of 1966: $7,834,029
Total investments announced during the calendar year 1965: $23,148,079
Recent Activity

INTERNATIONAL MONETARY FUND

THE FIRST QUARTER of 1966 was another busy period for the International Monetary Fund. New drawings during the quarter were made by 19 member countries, in the total amount of $478 million. Outstanding drawings at the end of March had risen to $4,580 million, an increase of $226 million since the beginning of the year. The cumulative total of all drawings made on the Fund since it began operations in March 1947 had climbed to $11.9 billion.

Transactions during the quarter included drawings by Argentina, Ireland, and the United States, as well as those made by 8 other countries under existing stand-by arrangements. Twelve countries drew on the Fund to help finance the payment of their additional quota subscriptions. These were Burundi, Ceylon, Colombia, Haiti, India, Liberia, New Zealand, Somalia, the Sudan, the Syrian Arab Republic, the United Kingdom, and Yugoslavia.

New stand-by arrangements in continued support of stabilization programs were announced for eight countries during the quarter. These included four Latin American republics, Brazil, Chile, Costa Rica, and Peru, and two countries in Africa, Burundi and Somalia, as well as new arrangements for Korea and Turkey. At the end of March, the Fund was maintaining stand-by arrangements with 23 members, and undrawn balances under these arrangements amounted to $433 million.

The largest single transaction agreed during the quarter was a drawing equivalent to $187.5 million made by the Government of India to help meet that country’s payments difficulties caused by drought. Unfavorable weather conditions, which last year extended over most of the country, have severely reduced the production of foodgrain and industrial raw materials in India, and also of several commodities important to its export income, especially jute, oilseeds, and tea. Shipments of grain from the United States and other countries will alleviate India’s difficulties, but exceptional foreign exchange expenses remain.

The drawings of $187.5 million by the Government of India, announced on March 23, was effected early in April in ten currencies, as follows: $37.5 million in French francs; $25 million in U.S. dollars; $25 million in pounds sterling; $25 million in Italian lire; $15 million in Canadian dollars; $15 million in Netherlands guilders; $15 million in Belgian francs; $10 million in deutsche mark; $10 million in Japanese yen; and $10 million in Australian dollars.

This brought India’s outstanding drawings on the Fund to the equivalent of $475 million.
India's quota in the Fund had been previously increased from $600 million to $750 million.

Quota Increases

Increased quotas in the Fund became effective for many members during the first quarter after the two Resolutions approved by the Fund's Board of Governors in March 1965, proposing general and special quota increases, had become effective as from February 24, 1966. By that date, 59 member countries, representing 67.82 per cent of total Fund quotas, had notified the Fund of their consent to a quota increase. Under the terms of the Resolutions, members having not less than two thirds of the total quotas in the Fund as of February 26, 1965 were required to consent to their individual quota increase before any of the proposed increases came into effect.

By the end of March, the number of countries consenting to their quota increases had risen to 78, and 53 of these members had completed their additional subscription payments. As a result, total quotas in the Fund on March 31, 1966 had risen to $19,231 million.

The period in which the remaining members of the Fund may consent to their quota increase has been extended until July 31, 1966. When all the proposed quota increases have become effective, total quotas in the Fund are expected to rise to about $21 billion.

### DRAWINGS BY MEMBERS DURING THE FIRST QUARTER OF 1966

<table>
<thead>
<tr>
<th>Member</th>
<th>Month</th>
<th>Amount ($ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Afghanistan</td>
<td>January, March</td>
<td>3.38</td>
</tr>
<tr>
<td>Argentina</td>
<td>January</td>
<td>30.00</td>
</tr>
<tr>
<td>Burundi</td>
<td>March</td>
<td>.94 *</td>
</tr>
<tr>
<td>Ceylon</td>
<td>January, March</td>
<td>11.50 *</td>
</tr>
<tr>
<td>Chile</td>
<td>March</td>
<td>10.00</td>
</tr>
<tr>
<td>Colombia</td>
<td>January, March</td>
<td>19.75 *</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>March</td>
<td>2.00</td>
</tr>
<tr>
<td>Haiti</td>
<td>January, March</td>
<td>.70 *</td>
</tr>
<tr>
<td>Honduras</td>
<td>March</td>
<td>2.50</td>
</tr>
<tr>
<td>India</td>
<td>March</td>
<td>37.50 *</td>
</tr>
<tr>
<td>Ireland</td>
<td>January</td>
<td>22.50</td>
</tr>
<tr>
<td>Liberia</td>
<td>January, March</td>
<td>2.19 *</td>
</tr>
<tr>
<td>New Zealand</td>
<td>March</td>
<td>8.00 *</td>
</tr>
<tr>
<td>Somalia</td>
<td>March</td>
<td>.94 *</td>
</tr>
<tr>
<td>Sudan</td>
<td>March</td>
<td>3.00 *</td>
</tr>
<tr>
<td>Syria</td>
<td>February, March</td>
<td>3.25 *</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>March</td>
<td>122.50 *</td>
</tr>
<tr>
<td>United States</td>
<td>January, March</td>
<td>160.00</td>
</tr>
<tr>
<td>Yugoslavia</td>
<td>March</td>
<td>37.50 *</td>
</tr>
</tbody>
</table>

Total drawings in the first quarter of 1966: 478.14
Total net drawings at the end of the first quarter of 1966: 4,579.80

* Drawings made in connection with payments of additional quota subscriptions.
### STAND-BY ARRANGEMENTS
**APPROVED DURING THE FIRST QUARTER OF 1966**

<table>
<thead>
<tr>
<th>Member</th>
<th>Month</th>
<th>Amount ($ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>February</td>
<td>125.0</td>
</tr>
<tr>
<td>Burundi</td>
<td>March</td>
<td>5.0</td>
</tr>
<tr>
<td>Chile</td>
<td>February</td>
<td>40.0</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>February</td>
<td>10.0</td>
</tr>
<tr>
<td>Korea</td>
<td>March</td>
<td>12.0</td>
</tr>
<tr>
<td>Peru</td>
<td>March</td>
<td>37.5</td>
</tr>
<tr>
<td>Somalia</td>
<td>January</td>
<td>2.8</td>
</tr>
<tr>
<td>Turkey</td>
<td>January</td>
<td>21.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>253.8</strong></td>
</tr>
</tbody>
</table>

### FUND STAND-BY ARRANGEMENTS
(As at March 31, 1966)

In millions of U.S. dollars

- **Amounts Drawn**
- **Amounts Agreed**

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USE OF FUND'S RESOURCES
(As at March 31, 1966)

FUND HOLDINGS OF CURRENCY
As % of Quota

NET DRAWINGS
In millions of U.S. dollars

AFGHANISTAN
ARGENTINA
BOLIVIA
BRAZIL
BURUNDI
CEYLON
CHILE
COLOMBIA
COSTA RICA
CYPRUS
DOMINICAN REPUBLIC
ECUADOR
GHANA
GUATEMALA
HAITI
HONDURAS
INDIA
IRAN
IRELAND
LIBERIA
MALI
MOROCCO
NEW ZEALAND
NICARAGUA
PAKISTAN
PANAMA
PHILIPPINES
SOMALIA
SUDAN
SYRIAN ARAB REPUBLIC
TUNISIA
TURKEY
UNITED ARAB REPUBLIC
UNITED KINGDOM
UNITED STATES
URUGUAY
YUGOSLAVIA

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Contributors to This Issue

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J. V. Mládek is Director of the Central Banking Service in the Fund. Until 1964, he was in charge of the African Department, and he has occupied various other positions in the Fund, including those of Executive Director and of Director of the European Office in Paris. Before joining the Fund, he served in the Czechoslovak Ministry of Finance and was Director and Commissioner of the National Bank of Czechoslovakia.

Pierre-Paul Schweitzer in 1963 became the fourth Managing Director of the Fund. Before World War II, he was a member of the staff of the French Treasury. After the war he held senior positions in the French Embassy in Washington, in the French Treasury, and in the Bank of France.

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Early in 1964, when a World Bank mission was invited to Morocco to survey the economy, the country was in a financial crisis brought about by continued budget deficits and dwindling foreign exchange resources; also, population was growing at a rate twice that of national output. Emergency measures succeeded in 1965 in reversing the dangerous trend; longer-range need was for an investment program that would bring about a suitable rate of growth of output, while containing public expenditure within the bounds of fiscal possibilities and the amount of external assistance likely.

The mission's report set out a six-year program of investment designed to produce greater and more rapid returns. There is much emphasis on investment in agriculture, which must continue to employ most of the country's 13 million population, feed its multiplying numbers, and replace food imports to save foreign exchange. As an increasingly important earner of foreign exchange, tourism is considered ripe for extensive exploitation by both local and foreign capital. Although a cut is recommended in the share of investment going to social services, absolute amounts will be higher by the end of the decade than at its beginning. Top priority goes to increasing the supply of skilled manpower through expanding secondary education and technical training. While recognizing the inherent difficulties, the mission sharply underlines the threat posed by rapid population growth to real development progress as a whole.

The Moroccan Government adopted its own Three-Year Plan (1965-67) while the mission's report was in preparation. The mission believes that its program would aid the Government in its preparation of a plan for 1968-70, and would be helpful in the annual review in 1966 and 1967 of the current Three-Year Plan.

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PULP LOGS IN FINLAND
(SEE "STABILIZING AN ECONOMY", PAGE 107)