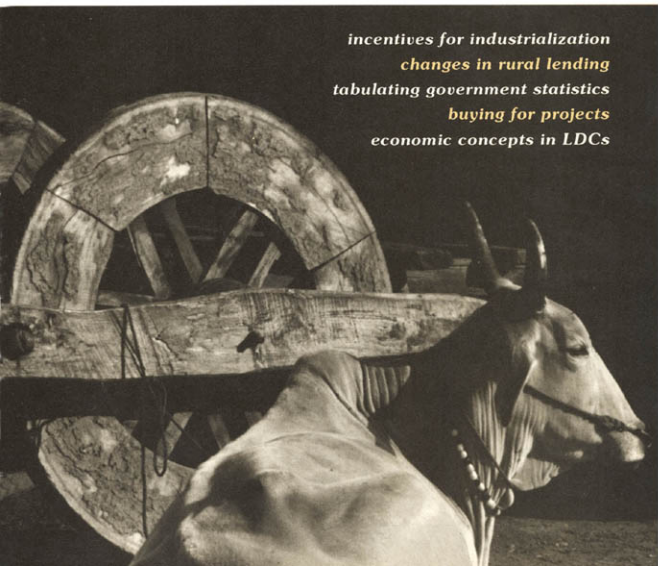


A quarterly publication of the  
International Monetary Fund and the World Bank Group  
June 1975 / Volume 12 / Number 2

# Finance & Development



*incentives for industrialization  
changes in rural lending  
tabulating government statistics  
buying for projects  
economic concepts in LDCs*

## From the Editor

The world economic scene is constantly changing, and so are the concepts that are useful for its analysis. Recent comments on the need for change illustrate the intellectual environment in which international economic institutions are now operating. We are therefore using our Views and Comments section to include some of those thoughts. In later issues, the current idea of a new international economic order will be examined from more than one point of view.

A number of articles in this issue of **Finance & Development** illustrate the nuts and bolts character of many Fund and Bank activities. Mr. John King explains step by step how goods and services are obtained under projects supported by the Bank. Mr. Sassoon describes how these processes of procurement are controlled. Ms. Guerard, of the Fund, compares the effectiveness of two main ways that can be used for stimulating industrialization in developing countries. Rural sector lending presents special problems, which are discussed in the contribution by Messrs. Bates and Donaldson. Mr. Tun Wai's article discusses the concepts and policies specially relevant to the problems of developing countries.

One of the major spin-offs from recent economic developments round the world has been the realization that the Bretton Woods institutions have a mutually complementary role to play in achieving fiscal and developmental stability for their members' states. This journal, as a publication of both the Bank and the Fund, attempts to reflect their work in the context of the world economic situation.

The Bank Activity article provides an illustration of the social, as well as economic, concerns of the Bank. It highlights the recently issued health policy paper, and the fight against schistosomiasis in the Sudan, supported by the Bank. The Fund's activities continue to include measures to assist countries in short-term economic difficulties, and stand-by arrangements are a particularly important part of that assistance.

There is a fairly large volume of mail arriving at our office each month, some with comments on articles or issues. Our newly introduced Letters to the Editor column will, we hope, give readers a chance to share their views on the journal and the issues covered by it. We invite your comments so that we can improve communications among ourselves and thus bring about an even better journal for you the next time.

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## Fund activity

### Funding the Oil Facility for 1975

Terms and conditions for financial assistance by the Fund under its oil facility for 1975 to members experiencing difficulties in their balance of payments due to the increased cost of oil imports were announced by the Fund in April. Mr. H. Johannes Witteveen, the Fund's Managing Director, held discussions in February and March with a number of oil exporting countries and countries in strong balance of payments positions in the Middle East, Europe, and Latin America on possible lending to the facility. A target figure for such lending of the equivalent of SDR 5 billion was set by the Interim Committee of the Board of Governors at its January meeting in Washington. As of March 31, 1975, purchases amounting to the equivalent of SDR 2.5 billion had been made by 38 member countries of the Fund under the oil facility for 1974.

In the light of the Interim Committee's discussions and other developments, the terms and conditions of the oil facility for 1975 have a number of modifications compared with the one for 1974. Subject to the assessment by the Fund of the member country's balance of payments needs, total access to the facility for 1975 is determined more by a formula related to the member's quota in the Fund and less by one related to the calculated increase in the member's oil import cost than it was under the facility for 1974. However, in no instance will the member's access be less than one third of the increase in its oil import costs nor less than its maximum calculated access under the 1974 oil facility. A review of the oil facility for 1975 will be conducted by the Executive Board of the Fund in July and, until then, the initial access by a member may not exceed 30 per cent of its total access.

Access to the oil facility for 1975 will also

be subject to stricter policy conditionality than in 1974. Each member country that wishes to make a drawing under the facility will describe its policies to achieve medium-term solutions to its balance of payments problems, and access to the facility will be subject to an assessment by the Fund of the adequacy of these policies. In addition, each drawing member will describe any measures to conserve oil or develop alternative sources of energy it has taken or proposes to take in the light of its economic situation. As in 1974, access to the facility will depend on an undertaking by the member to avoid the introduction or intensification of restrictions on external payments as well as on international transactions unless it has consulted the Fund in advance.

The period for which drawings under the oil facility may be outstanding will be seven years, the same as in 1974. Charges on a member's outstanding drawings will be at an average rate of 7 3/4 per cent, compared with an average of 7 per cent in 1974. An interest rate of 7 1/4 per cent has been arranged for borrowings from those countries providing loans to the oil facility for 1975.

The cut-off date for requests for purchases under the oil facility for 1974 was February 27, 1975. An amount equivalent to SDR 3,038.745 million has been made available to the 1974 oil facility through borrowing agreements with nine lenders. As of March 31, 1975, 38 member countries had made purchases amounting to the equivalent of SDR 2.5 billion. Although the size of the oil facility was small compared with the estimated increase in the current account surpluses of the major oil exporting countries, it was important in relation to the increase in the current account oil deficits of the 31 non-oil exporting developing countries that made use of the oil facility. For these countries, the use of the 1974 oil facility was an important factor in avoiding an escalation of restrictions on trade and payments and the implementation of an unduly abrupt adjustment. For the aggregate of developing countries that have used the facility, purchases have totaled over 40 per cent of the calculated cost increase in their oil imports from 1973 to 1974. This percentage was still higher for developing countries in the Western Hemisphere (63 per cent) and in Africa (72 per cent).

On a regional basis, of the SDR 2.5 billion purchased under the oil facility for 1974 by March 31, 1975, the largest share (SDR 675 million) constituted a purchase by one industrial European country (Italy). Other developed countries drew the equivalent of SDR 794.6 million. Developing countries in Asia drew the equivalent of SDR 520.34 million, in Latin America the equivalent of SDR 234.067 million, and in Africa the equivalent of SDR 181.154 million, while three countries in the Middle East region drew the equivalent of SDR 79.06 million.

### Meeting of Interim Committee

At the end of March the Fund announced that the next meeting of the Interim Committee of the Board of Governors on the International Monetary System would be held in Paris on June 10 and 11 at the Hotel Majestic, the international conference center of the French Government. The meeting, it was announced, would be preceded by meetings of the Group of 24, representing developing countries, and the Group of 10, representing industrialized countries. The agenda for the Interim Committee meeting would include a review of possible amendments to the Fund's Articles of Agreement, the proposed increase in quotas in the Fund, and the operation of the oil facility for 1975.

### Stand-by arrangements—how they function

The stand-by arrangements for Israel and Chile, which were approved by the Fund's Executive Board on February 14 and March 19, respectively, bring the total of stand-by arrangements approved for member countries of

Table 1  
Fund holdings of selected currencies  
March 31, 1975

Currency	Amount (SDR millions)	Per cent of quota
Argentine pesos	488.7	111.1
Australian dollars	491.4	73.9
Austrian schillings	130.4	48.3
Bahrain dinars	3.5	35.0
Belgian francs	125.9	19.4
Canadian dollars	796.9	72.4
Ecuadoran sucres	20.8	62.9
French francs	1,050.2	70.0
Deutsche mark	195.5	12.2
Indonesian rupiahs	190.0	73.1
Irish pounds	79.2	65.4
Japanese yen	575.9	48.0
Kuwaiti dinars	28.2	43.4
Malaysian dollars	136.5	73.4
Mexican pesos	272.2	73.6
Netherlands guilders	335.1	47.9
Norwegian kroner	162.1	67.5
Omani rials	3.2	46.4
Qatar riyals	7.0	35.0
South African rand	238.8	74.6
Swedish kronor	238.1	73.3
U.A.E. dirhams	7.2	48.3
U.K. pounds	2,574.1	91.9
U.S. dollars	4,941.4	73.8
Venezuelan bolivares	168.1	50.9

the Fund since the instrument was first established in 1952 and until the end of March 1975 to 361, the equivalent of SDR 21,137 million. Peru with 16 stand-by arrangements; Colombia with 15; Haiti with 14; Chile with 13; and Bolivia, Honduras, and the Philippines with 12 each have been the most frequent recipients of stand-by arrangements from the Fund.

The first stand-by arrangement amounting to \$50 million was extended to Belgium in June 1952, prior to the approval of the first general policy decision on the new instrument on October 1, 1952. The stand-by arrangement rapidly emerged as the main instrument by which the Fund makes its resources available to members and has been employed to deal with a wide range of different problems. Stand-by arrangements have been approved in order to (1) sustain confidence in currencies under pressure because of a variety of international difficulties or emergencies, (2) provide additional resources during seasonal difficulties, (3) support economic stabilization programs, and (4) provide backing for exchange reform and other purposes.

Stand-by arrangements have often been used, not to deal with immediate problems but to avert problems by encouraging member countries to continue sound monetary and fiscal policies. For this reason there have been many stand-by arrangements under which members have made no purchases. Stand-by arrangements also serve as an endorsement of a member country's economic program by demonstrating that the Fund's resources are available to it.

When considering a request for a stand-by arrangement, the Fund applies the same policies it applies to requests for direct purchases, which include review of the member country's position, policies, and prospects in relation to the objectives of the Fund. Stand-by arrangements are designed to correct medium-term balance of payments problems of a member country. The stand-by period was originally fixed at six months, but from the beginning of its operation, periods of one year were agreed, and since 1956 the one-year period has become normal. Repayment of the amounts purchased is required to be made not later than three to five years from the date of purchase.

For stand-by arrangements beyond the first credit tranche (which bring the Fund's holdings of the member country's currency to more than 125 per cent of quota), the resources committed by the Fund are phased through the stand-by period. The member country's right to purchase depends on its observance of performance criteria, and provision is made for consultation concerning its position and performance. Gradually, as experience with stand-by arrangements has grown, the Fund has been able to rely on fewer and less complex performance criteria.

Certain objective tests or performance

Table 2  
Summary of stand-by arrangements  
that became effective during  
the fiscal years ended  
April 30, 1953-75.  
(in millions of SDRs)

Fiscal Year	Number of stand-by arrange- ments approved	Total amount approved
1953	2	55.00
1954	2	62.50
1955	2	40.00
1956	2	47.50
1957	9	1,162.28
1958	11	1,043.78
1959	15	1,056.63
1960	14	363.88
1961	15	459.88
1962	24	1,633.13
1963	19	1,531.10
1964	19	2,159.85
1965	24	2,159.05
1966	24	575.35
1967	25	591.15
1968	32	2,352.36
1969	26	541.15
1970	23	2,381.28
1971	18	501.70
1972	13	313.75
1973	13	321.85
1974	15	1,394.00
1975*	14	389.75
		18,977.07

\*To March 31 only.

criteria are employed to determine the observance by the member country of the policies outlined in the stand-by arrangement. These criteria may include the total amount of credit extended by the member country's central bank, the avoidance of restrictions on external payments and, in some instances, external debt limits and fiscal ceilings. In various exchange system situations, including a currency float, a balance of payments test has been used as an objective criterion in stand-by arrangements. This test takes two forms: a limitation on total net sales of exchange by the monetary authorities in the foreign exchange market or the maintenance of a minimum level of net foreign reserves.

The Fund opens negotiations for a stand-by arrangement with a member country on receipt of a request for such an arrangement. These negotiations are normally conducted between the member country's authorities and a staff

mission sent from Fund headquarters. They are designed to review the nature and difficulty of the problem for which the arrangement is intended to provide assistance and to formulate the policies which the member will pursue in dealing with this problem. When the discussions are completed, the member country's representatives sign a letter of intent, which is transmitted to the Fund's Managing Director. The proposed stand-by arrangement and the letter of intent are annexed to a memorandum prepared by the staff and submitted to the Executive Board of the Fund for its consideration.

The number of stand-by arrangements approved by the Fund was comparatively limited during the early years. Only 2 were approved each year during the fiscal years 1952/53 to 1955/56. From 1956/57 the number began to increase, rising to 24 in 1961/62, 1964/65, and 1965/66, 25 in 1966/67, and 32 in 1967/68. Thirteen stand-by arrangements were approved in 1971/72 and 1972/73, 15 in 1973/74, and 14 in the period May 1, 1974 to March 31, 1975. (See Table 2.) A reason for the decline in the number in 1971/72 and 1972/73 was the considerable increase in those years in the world market prices of many of the primary commodities that developing countries export.

Some of the largest stand-by arrangements approved by the Fund have been those for the United Kingdom, which received stand-by arrangements equivalent to SDR 738.5 million in 1956, SDR 1,000 million in 1962, and SDR 1,400 million in 1967; Italy, which received a stand-by arrangement equivalent to SDR 1,000 million in April 1974; France, with a stand-by arrangement equivalent to SDR 985 million in 1969; Japan, with one equivalent to SDR 305 million in 1962; Brazil, with one equivalent to SDR 125 million in 1965; and Argentina, with stand-by arrangements equivalent to SDR 100 million in 1960 and SDR 125 million in 1967.

The basic source of information on the history and development of the stand-by arrangement is *The Stand-by Arrangements of the International Monetary Fund* by Joseph Gold, the Fund's General Counsel. Mr. Gold's book (295 pp.) is available for \$4.00, or the equivalent in most other currencies, from The Secretary, International Monetary Fund, Washington D.C. 20431.

## General Account

In the first quarter of 1975 member countries purchased the equivalent of SDR 588.85 million under the regular facilities of the General Account, with repurchases amounting to the equivalent of SDR 96.06 million. Total gross purchases under the General Account since the beginning of Fund operations reached SDR 31,663.2 million by the end of March. Fund holdings of selected currencies as of



March 31, 1975 are shown in Table 1.

## Special Drawing Account

In the first quarter of 1975, one participant in the Special Drawing Account used a total of SDR 3.0 million to obtain currencies from one other participant designated by the Fund.

During the quarter the Fund's General Account received a total of SDR 6.5 million from five participants that used SDRs in repurchases in the General Account and SDR 46.3 million from 50 participants that paid charges relating to their use of the Fund's resources. The Fund transferred a total of SDR 19.5 million to 14 participants in transactions to

promote the reconstitution of their SDR holdings and SDR 0.1 million to one other participant in payment of interest for the borrowings made to finance transactions under the oil facility.

Holdings of SDRs in the General Account at March 31, 1975 were SDR 490.3 million

Ian S. McDonald



## Equating health with wealth

Poverty continues to be a major cause of ill health around the world according to a study by the World Bank on health issues.

The 83-page *Health: Sector Policy Paper*, released recently notes that health conditions in developing countries have improved considerably in recent decades. Nevertheless, it states that "international differences in health levels remain substantial: within nations, differences in the health of the rich and the poor are no less wide."

The study adds that from available evidence it appears that health conditions among the poor in different countries are basically similar.

"The poor suffer from a core of fecally-related and air-borne diseases. Malnutrition increases the susceptibility to many of these diseases and compounds their severity," according to the study.

The Bank policy paper notes that health policies are inefficient and inequitable in many developing countries, and concludes that governments need to curtail their expenditures on hospitals and highly trained personnel, and devote more resources to the staffing of low-level health services in areas with little or no facilities.

The paper advises that "reforms in the service offered to the poorer people should concentrate on improving health at the community level. The objectives should include changes in living habits and attitudes, as well as household and community activities to improve water supply and sanitation."

The World Bank has, in the past, initiated project lending in a number of areas that directly affect health, such as water and sewerage, population planning, education, rural development, irrigation and drainage, and urbanization.

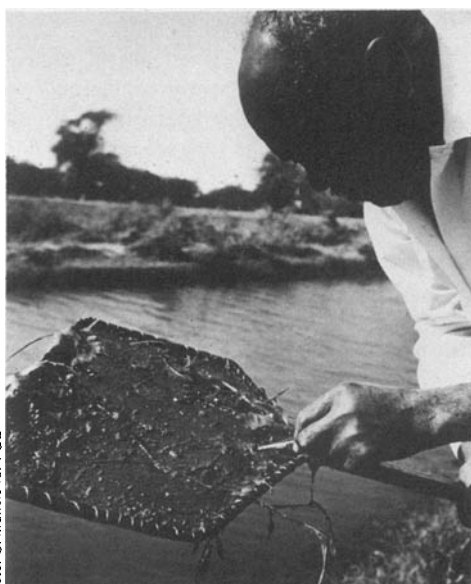
For the future, the Bank has decided that it will continue "to strengthen its awareness of the health consequences of the projects it supports, and of opportunities for improving health that are available under present patterns of lending."

In other words, while the health benefits of projects are expected to increase, the patterns of lending will remain basically unchanged.

## Battling Bilharzia in the Sudan

*"The effects of bilharzia are not unknown. The kinds of sanitary regulation needed to lessen the risks of infection are at least as important, in terms of human welfare, as the stresses of concrete in the dam or the safe transmission of high voltages of electricity. It is just as inconvenient to be killed by a sanitary failure as to be drowned by an engineering one. The only clear advantage is that the drowning may be quicker."*

*Only One Earth*, by Barbara Ward and René Dubos, page 161.



Expert sifts through snails scooped from canal in Gezira region of the Sudan for species that spread schistosomiasis.

Dr. El Sunni Amin, senior public health inspector in charge of bilharzia control, was in his office at Wad Medani, the Sudan, looking through the microscope at the schistosomes. "It's probably the most prevalent occupational disease in the world," he said.

Among the schistosomes he was examining were the species *Schistosoma haematobium*, and *Schistosoma mansoni*. Both infect a quarter of a billion people around the world with a chronic disease called bilharzia, or schistosomiasis. Though most people do not die of the

## Bank Group projects with schistosomiasis control components

Country	Nature of project	Date
Brazil	Hydroelectricity	1974
Cameroon	Irrigation	1972
Egypt	Water drainage	1973
Indonesia	Irrigation	1970
Malawi	Rural development	1972
Mali	Irrigation	1971
Morocco	Irrigation	1974
Philippines	Rural development	1975
Sudan	Irrigation	1973
Syria	Irrigation	1974

disease, the productive lives of a great majority are greatly reduced.

Schistosome cercariae (larvae at tadpole stage) are picked up by humans who wash or bathe in infected waters. The cercariae penetrate the skin, mature into adult worms, and lay eggs in small veins associated with the bladder or intestine. Most of the eggs then exit from the body in either the urine or feces. Some worms lodge in the liver and other organs, causing tissue damage; still others remain on the bladder and intestine walls and give rise to calcification and cancer.

When the eggs are excreted into the water, they change into larvae, and are harbored by host snails, where the life cycle of the schistosome is repeated. Without the snail—*Bulinus truncatus* and *Biomphalaria glabrata* are the two most common varieties in Africa—there would be no schistosomiasis.

Wad Medani is located in the middle of the Gezira, a large, flat plain lying between the Blue and White Nile rivers south of the coun-

### World Bank loans approved during third quarter of fiscal 1975

(ended March 31, 1975)

Country	Purpose	Amount (\$ millions)
Brazil (2)	Highways, railways	285.0
Colombia (3)	DFC, water supply, telecommunications	47.5
Egypt (2)	Industry, railways	77.0
Honduras	Power	35.0
Indonesia	Industry	115.0
India	Industry	109.0
Ivory Coast (3)	Cotton, sewerage, education supplement	42.2
Kenya*	Agriculture	7.5
Korea	Urbanization, DFCs, education	197.5
Romania (2)	Agricultural credit, irrigation	100.0
Sierra Leone	Highways supplement	2.3
Tunisia	Sewerage	28.0
Turkey	DFC	65.0
Zaire	Industry	100.0
Total loans during third quarter of fiscal 1975		1,211.0
Total loans during first three quarters of fiscal 1975		2,420.85

\*With a \$7.5 million IDA credit

### IDA credits during third quarter of fiscal 1975

(ended March 31, 1975)

Country	Purpose	Amount (\$ millions)
Bangladesh (3)	Industry, population, imports	73.0
Ghana	Oil palm	13.6
India (3)	Industrial imports (2), agriculture	245.0
Jordan	Education	6.0
Kenya*	Agriculture	7.5
Malawi	Rural development	8.5
Mali (2)	Livestock, rice irrigation supplement	15.9
Senegal	Education	15.0
Western Samoa	Highways	4.4
Yemen, P. D. R.	Fisheries supplement	1.6
Zaire	Highways	26.0
Total credits during the third quarter of fiscal 1975		416.5
Total credits during first three quarters of fiscal 1975		971.55

\*With a \$7.5 million Bank loan

try's capital of Khartoum. On this plain is the world's largest farm, the Gezira Scheme: more than 2 million acres, tended by about 100,000 tenant farmers and their families. Six thousand acres of cotton are cultivated each year, on the Gezira, and the cotton is picked by a half

million migrant workers who come from all parts of Africa to earn a cash income.

Cotton, the source of wealth of the Gezira Scheme, can be raised because of the Scheme's extensive irrigation network. Children swim in the canals; women wash the family clothes in

the canals; men work in fields by the canals, and bathe and cool off in its waters. The same snail-infested waters account for the fact that the men, women, and children of the Gezira Scheme—in some villages as many as 80 per cent of them—are infected with bilharzia.

Most of the Gezira villages are within 300 meters of the irrigation canals. Dr. M.H. Satti, who works at the National Health Laboratory in Khartoum, says that villages should be located at least a kilometer from the water.

"It might not be much of an advantage for the men who have to work in the fields," he says, "but it would help the small children who stay at home."

Little was known about schistosomiasis when the Gezira Scheme was first begun in 1911.

Later irrigation projects in the Sudan—in Managil (adjacent to Gezira and for which a \$19.5 million Bank loan was approved in 1961), and in nearby Rahad (for which IDA extended a \$42 million credit in 1973)—have included protective health services in the blueprints from the beginning. Villages are furnished with safe, assured supplies of water for drinking, bathing, and laundering while the villages themselves have been located away from canals. Schools have been built so children may not spend their idle time at snail-infested canal banks, where schistosomiasis lurks. Workers in the fields, however, must be protected in other ways.

Until five years ago, the only method of controlling the snail population in the developing world was to apply copper sulphate to the water. The chemical had a kill radius of only 100 meters. Moreover, it had a relatively low poisonous effect on snails, and was not "host specific"—meaning that it proved toxic for other, possibly useful organisms in the water, as well as the snails, which carried schistosomiasis.

Today, petroleum-based chemicals are proving their worth—but at a great cost. Before the dramatic increases in prices for petroleum products, the Sudan had begun a snail eradication campaign in the Gezira using a molluscicide developed by the Shell Oil Company. The cost for controlling snails in the Gezira is \$1.50 an acre yearly (for a minimum of from three to five years) or about \$9 million to \$15 million.

In spite of the new molluscicides, however, public health officials in the Sudan realize that schistosomiasis will never be eradicated in the country. "If we reduce the incidence of the disease to 15 per cent of the population living in irrigated areas, we will have done a good job," said one official.

Until that can be done, the Sudan and other countries throughout the developing world will experience productivity losses from workers infected with the schistosome worms.

Peter C. Muncie



The Bank plays an important role in the procurement of goods and services for projects that it finances. There has been some criticism of the Bank's handling of this task as its disbursements for procurement purposes have risen over the years. The author, who works in Central Projects in the Bank, examines the history of the procurement process and answers the critics.

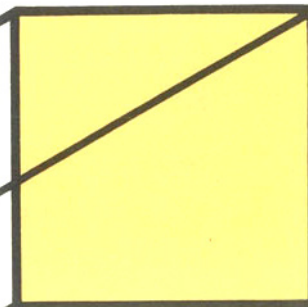
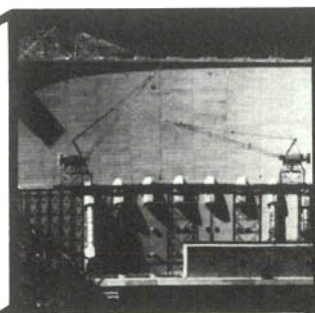
A second article, on the Bank's procurement guidelines, immediately follows in this issue.

**John A. King**

The cost of procuring goods and services under World Bank development projects (including the International Development Association (IDA) after 1960) from the time the Bank opened its doors in 1946 to June 30, 1974 has amounted to \$18,770 million. Procurement costs paid by the Bank first reached an annual rate of \$1,000 million in fiscal year 1967 and of \$2,000 million in fiscal year 1974; during fiscal years 1970-74 they averaged slightly over \$1,500 million a year.

The Bank's interest in procurement under its loans stems directly from the "project" requirement of its Articles which stipulates that it should lend for specific projects, except in special circumstances, and that it should ensure that the proceeds of the loan are used only for its specified purpose, with due attention to economy and efficiency. These requirements, among others, were included in the Articles to prevent a recurrence of some of the unsound practices characterizing international lending in the nineteenth and early twentieth centuries. They make it necessary for the Bank to ascertain what happens to the money it lends, and to supervise the execution of the projects it helps to finance, including the procurement of the necessary goods and services for them. But the Articles do not give much guidance about procure-

## Procurement under World Bank projects





ment policy and practice, and not all of the considerations which go into current policy and practice were evident in 1946.

Scarcity was the controlling factor in procurement during the late 1940s and early 1950s. As productive capabilities of Europe and Japan had been extensively damaged by World War II, those countries were not interested in production for export. Virtually the only source of supply for capital goods was the United States. During this time, the Bank's primary concern with procurement was to help borrowers locate sources of supply for the goods and services they needed and to get the necessary government priorities (usually in the United States) to procure them. International competitive bidding was then irrelevant.

Yet, during that early period the Bank made a crucial policy decision on project execution, including procurement, that is even more appropriate in today's very different development climate. It decided that the ultimate responsibility for project execution rests with the borrower and not with the Bank. This policy set limits to the Bank's role in procurement: the Bank can be (and is) a legislator and a judge but never the executive.

Simultaneously, the Bank recognized that its borrowers often lacked the skills to conceive, design, and carry out the development projects which the Bank was being asked to help finance. To assist in meeting these deficiencies the Bank began recommending at an early stage that its borrowers and potential borrowers engage consultants to help carry out this work. The concept of engineering consultants, responsible only to the standards of their profession and independent of manufacturers of equipment or of contracting or construction firms, was the accepted commercial practice in Canada, the United Kingdom, and the United States. This concept, with its obvious advantages of professional competence, integrity, and lack of financial interest in any particular solution, therefore, became an element of the Bank's procurement policy.

The consultants were selected and engaged by the borrower, after consultation with the Bank, on the basis of professional qualifications and experience but without price competition. However, since firms of independent consulting engineers were not a part of commercial practice in much of continental Europe or Japan, this difference in commercial practice led in later years to some question regarding the fairness of the Bank's procurement system.

## International competitive bidding

By the early 1950s, however, a considerable amount of reconstruction had been achieved in Europe, thus opening up additional sources of supply for the goods and services needed for Bank-financed projects. This change led the Bank to develop a more specific procurement policy, and in 1951 it began introducing international competitive bidding (ICB) as the normal procedure for procurement of the goods and works needed for its projects. ICB is based on international notification of the opportunity to submit bids, clear and fair specifications, and the awarding of the contract according to the bid which, after evaluation, was determined to be the lowest meeting the specifications. This procedure met the requirement of the Articles for economic and efficient execution, by helping the borrower to get the best value for its money

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while guarding against discrimination and corruption. It also achieved the objective, derived from the Bank's character as an international institution, of giving all member countries an opportunity to compete in the supply of goods and works, thus contributing to the free flow of trade and facilitating investment for productive purposes. The Bank's Engineering Adviser at that time, General R. A. Wheeler, played a large role in establishing this policy. General Wheeler came to the Bank from the U.S. Corps of Engineers, which traditionally has been responsible for the execution of large civil works through competitive bidding. His familiarity with these procedures and with the concept of independent consulting engineers undoubtedly helped to establish these concepts as the basis for the execution of projects financed by the Bank. But the Bank could not in the long run have disregarded competitive bidding, the most widely employed safeguard against waste, corruption, and discrimination in procurement by public bodies.

ICB was ideally suited for the type of project which the Bank was financing in the 1950s and early 1960s. The projects, more than two thirds of which dealt with power and transport, consisted of large

civil works such as dams, major highways, and ports, or of heavy equipment such as electric generators, locomotives and rolling stock, and steel-making or mining machinery. These projects were designed by foreign consultants, and built by foreign contractors with equipment supplied from abroad. Since very few countries supplied a major part of these goods and services at that time, 55.6 per cent of the payments for them went to manufacturers or contractors in the United States, the United Kingdom, Germany, and France during the period 1946-64.

## Expansion and changing concepts

By the early 1960s, however, circumstances affecting procurement under Bank-financed projects began to change. First, the Bank expanded its lending into new sectors. As a result, the Bank today lends for a wide variety of projects in agriculture, education, population planning, tourism, telecommunications, urban and rural development, and water supply, in addition to the traditional sectors of electric power and transport. Lending for agriculture, the single most important sector, amounted to almost \$1,000 million for about 50 projects in each of the last fiscal years 1973 and 1974. Further, the concept has evolved from the monolithic, capital-intensive, engineering-oriented project of the late 1940s and the 1950s to projects not only concerned with the transfer of capital but also with policy and institutional changes, the introduction and demonstration of new technology, and the improvement of the well-being of individuals. (See Chadenet and King, "What is 'A World Bank Project'?" *Finance and Development*, September 1972.)

This change in both scope and concept of projects has had an impact on procurement. The volume of Bank-financed business has grown greatly, from one \$250 million loan in fiscal year 1947 to 174 loans, totaling \$4,300 million, in fiscal year 1974, and it is expected to continue this expansion. Lending for power and transport is expected to grow in absolute terms in accordance with this trend, but the share of these sectors is declining. This means a different character of equipment and works to be financed—proportionately fewer turbines, generators, or locomotives and more school furniture, laboratory equipment, and simple farm machinery; proportionately fewer major civil works such as dams and ports and more land clearance, simple irrigation works, rural school buildings and family planning clinics.

*"the Bank has become more interested in the emergence of local manufacturers and contractors"*

There were also implications for international competitive bidding. The number of countries supplying goods and works has recently increased greatly, making competition more intense. The share provided by the four largest supplying countries (Germany, Japan, the United Kingdom, and the United States) has declined from 55.6 per cent for the period ended in fiscal year 1964 to 43.1 per cent in fiscal year 1974, when nine other countries—Australia, Belgium, Canada, France, Italy, the Netherlands, Sweden, Switzerland, and Yugoslavia—received an additional 20.3 per cent of disbursements. In addition, the pattern of competition among the developed countries has changed during the past decade, with a relative decline in the share of the United Kingdom and the United States and the emergence of Japan as a major supplier to the developing world (see the accompanying table). More important for the future, suppliers from a number of developing countries, such as Brazil, India, and Yugoslavia, are now successfully seeking business from Bank borrowers in other countries. There is also greater participation by manufacturers and contractors from the borrowing country itself, particularly for minor civil works, such as school buildings and feeder roads, and for simple equipment such as small farm machinery or school furniture.

These changes have brought about some modifications in procurement policy. With the growing concern for development and the developmental impact of its projects, the Bank has become more interested in the emergence of local manufacturers and contractors and it has been able to foster such institutions within the framework of its procurement policy through two methods.

First, it developed a policy of accepting a margin of tariff preference in the evaluation of bids for domestically manufactured goods: 15 per cent or the actual tariff, whichever is lower. This policy, formally adopted in 1962, represented a reasonable ad hoc effort by the Bank to reconcile its concern for the development of local industry and the impact of its projects on development with the consid-

erations of economy, efficiency, and international fairness and cooperation that had led to the adoption of international competitive bidding for procurement. For more than a decade, no similar preference was provided for local contractors because it was thought unnecessary in view of the natural advantages already enjoyed by the local contracting industry. In January 1974, however, the Bank's Executive Directors approved an experiment intended to foster the development of domestic civil works among contracting industries in countries with a per capita gross national product of \$200 or less, which are only 40 in number but include such large countries as Bangladesh, India, Indonesia, Nigeria, and Pakistan, through the application of a 7½ per cent preference in the evaluation of bids for bona fide, qualified, domestic contractors. The experiment initially covered civil works in projects approved by the Board during a one-year period ending in January 1975, but it has recently been extended for another year because of lack of experience during the first year to permit evaluation of its impact. The new policy also provides other measures and incentives to help to develop local contractors.

Second, the Bank recognized the need for more exceptions to the ICB procedure, because it was not economic and efficient to require it for the procurement of goods and works that were too small or too dispersed to be of interest to foreign suppliers and contractors. There had always been some exceptions—for example, when the need for standardization made it appropriate to buy new equipment from the supplier of the old units.



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There had also been projects for which ICB was not suitable, such as those where the loan was to a financial intermediary, a development finance company, or an agricultural credit agency for on-lending to local borrowers whose individual expenditures would be so small, varied, and extended over time that ICB was impracticable. With the changes in policy, the exceptions to ICB became more common and more extensive. Competitive bidding not notified internationally but advertised locally and carried out in accordance with local procedures (acceptable to the Bank) increasingly became the most economic and efficient way of procuring many project items, and construction by force account or "international shopping" was accepted for other items. Today, procurement is carried out in a variety of ways. Although ICB continues to be the norm, a very large number of transactions are governed by other forms of procurement.

### **Criticism of the procurement system**

Over the years, the Bank's procurement system has worked very well, in the judgment of most observers, but because the concepts on which it is based are of necessity an attempt to reconcile conflicting interests, it has given rise to frustrations and has been criticized both fairly and unfairly. There are conflicting interests among suppliers of goods and works from outside the borrowing country (usually but not always from developed countries), between suppliers from outside the borrowing country and local suppliers, and between the borrower itself and other concerns of its government. As legislator and judge, the Bank seeks to achieve a balance and equity among these interests.

As legislator, it sets down its rules in advance; these are outlined in its *Guidelines for Procurement Under Bank Loans and IDA Credits*, which were first published for general use in June 1964 and have been periodically revised since then. The procurement procedures for all project items are established, in conformity with the Guidelines, in the loan documents. Even for contracts entered into before the loan is approved and signed, these procedures must be followed if the Bank is to disburse for expenditures under these contracts.

As judge, however, the Bank has the alternatives of review before or after the event; it can either review the bidding documents before bidding is invited, as well as the evaluation of bids and pro-



# World Bank/IDA disbursements for goods and services related to projects

(Values in millions of U.S. dollars)

	Through fiscal year 1964		Through fiscal year 1974		Fiscal years 1970-74		Fiscal year 1974	
	(amount)	(per cent)	(amount)	(per cent)	(amount)	(per cent)	(amount)	(per cent)
Total disbursement	6,176.9	100.0	18,770.4	100.0	7,526.1	100.0	2,319.6	100.0
Largest sources of supply								
United States	2,014.5	32.6						
United Kingdom	682.7	11.1						
Germany	508.7	8.2						
France	230.3	3.7						
United States			3,913.5	20.8				
United Kingdom			1,995.9	10.6				
Germany			1,778.8	9.5				
Japan			1,589.6	8.5				
United States					1,116.4	14.8		
Japan					1,038.2	13.8		
Germany					762.6	10.1		
United Kingdom					630.1	8.4		
Japan							358.8	15.5
United States							268.7	11.6
Germany							208.8	9.0
United Kingdom							164.4	7.1
Total	3,436.2	55.6	9,277.8	49.4	3,547.3	47.1	1,000.7	43.1

Note: Since figures show disbursements, they may reflect contracts entered into in previous years.

posed award before it is made, or it can review the process as a whole after the award is made and when it receives the request for disbursement. In either case it decides whether the procedures established in the loan documents and the Guidelines have been followed. It is the practice today to require prior review for all significant transactions, in order to protect both the borrower and potential suppliers—the borrower from uneconomic procurement and the risk of not being reimbursed, and the suppliers from possible unfairness. This practice is, however, criticized sometimes by borrowers on the grounds that it is paternalistic and causes delays.

There are three major areas in the administration of procurement where the Bank has been subject to criticism:

## The Bank's role

- As mentioned earlier, the Bank takes the legal position that the ultimate responsibility for implementation of a project, and hence for procurement, rests with the borrower. But as a development institution, it is also concerned with improving the institutional capabilities of its borrowers. These considerations limit its role in the procurement process. If the borrower acts reasonably in selecting its consultants, and if the borrower and its agents prepare the bidding documents reasonably in accordance with accepted practice and evaluate the bids in a reasonable manner, the Bank cannot

substitute its judgment for theirs. This role is not always clearly understood by those who wish to supply the needed goods and services, and the Bank is often urged to involve itself more deeply in the selection of consultants, the preparation of specifications, or the evaluation of bids. But such involvement would not be in accordance with the legal responsibilities of the borrower; it would be a mistake as a matter of development policy, and it would be unmanageable administratively.

Inevitably, however, there are more losers than winners, and some of the losers may feel that theirs was the best offer and should have been accepted. Therefore, they may ask the Bank to intervene. The Bank will do so only if, after an examination of the facts, it concludes that the borrower or its consultants acted unreasonably or arbitrarily. And its intervention is limited as well; it cannot compel the borrower to award the contract to the lowest evaluated bidder determined in accordance with proper procedures if the borrower refuses to do so. The Bank's sanction is limited to refusal to disburse against a contract awarded contrary to proper procedures and to cancellation of that part of the loan.

## Consultants

- The role of consultants in the Bank's scheme of procurement poses several

problems. First, the concept of independent engineering consultants is not part of the commercial practice in many developed countries, and in many developing countries there is neither the concept nor the engineering capability in any form. This has led to criticisms of the national allocation of this type of work, when some countries believe that their engineering profession is discriminated against. There may be some foundation for this complaint. In at least one developed country, Italy, where the concept is not part of domestic commercial practice, consulting firms have developed which meet the Bank's standards and which do a substantial amount of business, financed by the Bank and from other sources, in developing countries. And a number of developing countries, notably Brazil, Colombia, and Mexico in Latin America, and India and Pakistan in Asia, now have a local professional capability, in some cases developed in response to the needs of Bank work.

A related complaint is that contractors and manufacturers from one country are alleged to be at a competitive disadvantage if the consultants are from another country, particularly when both consultants and contractors or manufacturers are from the same country. This disadvantage, it is said, could be the result of both witting and unwitting actions, possi-

bly arising out of differences in national engineering practices and standards. This complaint, however, is not borne out by experience. The Bank watches over this possible danger closely and requires, among other things, that the consultants prepare neutral specifications, so that no bidders from any country are favored. Also, the results of procurement demonstrate that the nationality of consultants is irrelevant; Germany and Japan have been remarkably successful in supplying goods and works for Bank-financed projects but very few consultants from these countries are responsible for the design and implementation of Bank-financed projects, and other countries which have supplied a substantial share of consultants, such as the United States and Canada, do not receive a proportionate number of procurement awards. It is worth noting that in the great hydroelectric projects which the Bank has helped to finance—Kainji, Kariba, Volta, Mangla, and Tarbela—the consultants were of a different nationality from that of the prime contractor. Finally, in these days of national sensitivity, it may be a positive disadvantage to both contractor and consultant if they are of the same nationality, particularly during the implementation phase; they may be suspected of uniting against the borrower in the case of claims or controversies.

In addition, two other criticisms of the consultant system have some merit. First, it is claimed that the system works against the selection of new firms, specialized firms, and local firms and that it favors the selection of large, established firms from the developed countries. The entity responsible for executing the project—for example, a national power authority—is more likely to know about the work of established firms (it may in fact already have a good working relationship with such a firm). In protecting itself against criticism, should something go wrong with the design or implementation of the project, it is safer for the entity to select the firm with an established international reputation than to take a chance with a new or a local firm. The system, with its emphasis on professional qualifications and the absence of competition on price, leans in this direction. In the few cases where the Bank itself is responsible for selecting the consultants (principally in the case of preinvestment studies financed by the United Nations Development Program), it tries to overcome these tendencies.

Second, the system is not always sympathetic to the technological needs of the

local economy. Consultants tend to design and implement projects in accordance with the technology they know best—usually that of the developed countries. In many cases, such as fertilizer or steel, this technology is as appropriate for a developing country as for a developed one, but in some situations it is not the most suitable and a new technology appropriate to local needs must be found. The system falters here, although there are sectors or subsectors where innovation is recognized

*“the Bank believes that it has an interest in helping the borrower to keep costs down and to implement the project on schedule”*

as a prerequisite and consultants are responsive to this need. Local consultants are not necessarily the answer in these situations, because they too may be trained in the technology of the developed countries.

Finally, there is the issue of the status of “independence” of consultants. Under the original concept of “independent consulting engineering,” the consultants were given a wide range of independence and authority to supervise the execution of the project, including the approval of modifications and the adjudication of claims, to make sure that the project was completed in accordance with the expectations of the client and within the terms of the contracts with suppliers and contractors. Today, contractors, suppliers, and the consultants themselves believe that this independence has been greatly eroded in practice. They feel that the consultants’ authority has been limited by the terms of their contract with the client or otherwise, in ways not always clear to the suppliers and contractors, so that consultants can no longer fully perform their traditional role. Many observers believe that these changes have an adverse effect on project execution by delaying decisions and by leading to additional disputes and claims with referral of more disputes to arbitration. These situations bring about rising costs for some projects and lead to higher contingency allowances in future bids or sometimes even to refusals to bid.

The Bank is often urged by consultants, contractors, and suppliers to

strengthen the independence of consultants. The Bank believes that it has an interest in helping the borrower to keep costs down and to implement the project on schedule, but there are limits as to what it can do. It is probably easier psychologically for a borrower with considerable technical competence of its own to give broad authority and independence to its consultants than for one without such competence to do so. And there may be some feelings in developing countries that this “independence” is a form of neocolonialism. The Bank’s most effective contribution in this area is to make certain that the exact extent of the consultants’ authority and any limitations are known to the suppliers and contractors concerned, and to help resolve any conflicts between the consultants and the borrower over project execution as soon as possible.

#### *The “fair share”*

- From time to time, individual manufacturers or contractors, their trade associations, or their governments complain that they are not receiving their “fair share” of procurement under Bank-financed projects. The developed countries have subscribed a major part of the Bank’s capital; for example, its four largest shareholders—the United States, the United Kingdom, Germany, and France—held 51.2 per cent of the shares in 1961 and 41.7 per cent in 1974. World Bank borrowings have also been concentrated in the developed countries, with the major source being the United States throughout the 1950s and much of the 1960s, but borrowings shifted to other capital surplus countries such as Germany and Japan in the late 1960s and 1970s, and most recently to some of the petroleum exporting countries. The developed countries have also provided the bulk of IDA funds.

The “fair share” argument, which has never been articulated very clearly, is that the capital supplied to the Bank for development by a country should be returned to it through the procurement of goods and services in the same country, in an amount proportionate to the capital it originally provided. This concept, which is analogous to “tied aid” in bilateral terms, appears to reflect feelings that are widely and instinctively held: (1) that a donor country should get a direct and prompt return for “aid given”; and (2) that suppliers from other countries have advantages for some reason over suppliers



from the country arguing for its "fair share" in getting information about business opportunities, in dealing with the international procurement system, or in obtaining assistance for exports. As proof, these businessmen and their representatives often point out that they are much more successful in getting business financed through their own national export-financed institution than through international sources such as the World Bank.

An early example of the "fair share" concept can be found in the Kariba project on the Zambezi River in what was then the Central African Federation and is now the boundary between Zambia and Southern Rhodesia. The project was financed by a joint effort which included the Bank, the British Commonwealth Development Corporation, private mining and financial companies, and the Central African Federation. The main contracts were let through international competitive bidding, with the result that the main civil works contract went to an Italian firm. *The Times* of London received many letters criticizing the use of ICB in these circumstances, and the attitude was summarized in the closing sentence of one letter: "As this is an Empire project it is, therefore, reasonable that a fair share of the contract, should accrue to Great Britain." Similar views have been expressed in other countries, such as the United States and Canada, when they were doing less well in procurement. But there seems to be no outcry against ICB when it provides a country with more than its "fair share."

These parochial views obviously run counter to the ICB concept and to the philosophy expressed in the Bank's Articles, particularly to the requirement that "the Bank shall impose no conditions that the proceeds of a loan shall be spent in the territories of any particular member or members." (Article 3, Sec. 5(a).) They are also mistaken in several respects. First, they appear to assume that the Bank is just another agency for the promotion of exports and they ignore the interest of the borrower and its country in getting the best value for its money. At the time of the Kariba bidding and awards, *The Times* also received letters from Africa defending ICB on the latter grounds. International competitive bidding does enable borrowers to take advantage of temporary pockets of excess capacity or localized lack of demand, and this advantage of the system goes not only to the borrower but also to the supplier who finds himself in this situation.

*Continued on page 31*

# Monitoring the procurement process

The author, who is in the Bank's Legal Department, discusses the latest set of World Bank and International Development Association (IDA) procurement Guidelines.

**David M. Sassoon**

The tenth and latest version of the *Guidelines for Procurement Under World Bank Loans and IDA Credits* is now being published. The first Guidelines for procurement of goods and civil works published by the World Bank in June 1964 were an extension of an internal checklist originally prepared in the public utilities division of the then Projects Department of the Bank as a guide for staff who supervised procurement of goods and works in the public utility sector. That checklist was later expanded, and the Guidelines presently cover procurement of goods and works in all lending sectors in which the Bank is active. Thus, what was contained in 1964 in a letter one or two pages long now occupies a substantial volume of printed matter, often taking up as much, if not more, space than all of the other provisions relating to the execution of the project under a loan or credit agreement (excluding the applicable General Conditions). The Guidelines, however, do not cover the procurement of consultant or transport and insurance services financed by the Bank.

This concern over procurement procedures is based upon the provision in its Articles of Agreement that the Bank pay due attention to considerations of economy and efficiency in the use of its loans. Thus the basic aim in the mind of the early framers of the Guidelines was to ensure that the borrower got the best contract at the most favorable price. This was the premise of the first set of Guidelines as instituted in June 1964.

With the passage of time, however, this underlying principle was to some extent compromised by other considerations that find expression in the procurement policies of several governments. For example, the Bank has for the past several years agreed to accept certain margins of domestic and even regional preferences in the comparison and evaluation of bids. Regional preferences apply in the case of customs unions or free trade areas between developing countries and are limited to 15 per cent of the c.i.f. price of nonregional goods or the difference in tariffs, whichever is the lower. Domestic preferences, amounting to the lower of either 15 per cent of the c.i.f. price of imported goods

or the customs duties which a nonexempt importer would have had to pay on such goods (duties which are otherwise to be excluded for the purpose of comparison of bids) were initially limited to contracts for the supply of goods or equipment. In January 1974, however, a 7½ per cent margin of preference was extended to domestic civil works contractors in the poorest countries on a trial basis. This preference presently extends to loans granted between January 22, 1974 and January 22, 1976 in the case of 40 countries with a \$200 or less per capita annual income. These preferences, which are to be applied at the request of the government of the borrowing country, reflect the broader objectives of the Bank as a lending institution for development and its increased participation in local currency financing. The fostering of domestic industries is clearly an important component of economic development, and a balance therefore had to be struck between this overall objective and the principle of economy and efficiency embodied in the Articles of Agreement. The new Guidelines will also state that "the Bank seeks through its procurement procedures to encourage the development of local industry (and that) suppliers and contractors in the borrower's country may bid independently or in joint venture with foreign suppliers or contractors," adding, however, that "the Bank does not approve conditions of bid invitation which require that foreign firms enter into compulsory joint ventures."

### International competitive bidding

The most recent edition of the Guidelines will be divided into Parts A and B, followed by Annexes which contain typical procurement provisions contained in loan agreements with the Bank—for example, those relating to preference eligibility and to the methods of computation of preferences. Part B and the Annexes will be entirely new, while Part A, which is exclusively devoted to international competitive bidding (ICB), is a substantially revised and rewritten version of what was formerly the entire body of the Guidelines. Part B, entitled "Other Procurement Procedures," for the first time expressly sets forth procedures other than ICB as an alternative means for achieving economy and efficiency. Nevertheless, the Guidelines still proclaim that "the Bank considers that in most cases international competitive bidding is the most economical and efficient method of procuring the goods and works required for the development projects it finances." At the same

*"price is only one of the important elements to be considered in bid evaluation"*

time, the interest of the industrial and capital exporting member countries in supplying goods and services for Bank-financed projects is not overlooked, and is in fact expressly acknowledged. "International competitive bidding," the Guidelines state "also ensures that suppliers and contractors from its members have an opportunity to compete in providing goods and works financed by the Bank."

ICB, which is sometimes also described as the principle of "untied aid," is thus, inter alia, designed to ensure that procurement will normally be open to suppliers and contractors of all member countries and Switzerland. ICB consists of: (1) notifying potential suppliers through embassies of Bank member countries and Switzerland of the opportunity to submit bids; and (2) advertising the invitation to prequalify or bid, as the case may be (locally, and, in the case of major contracts, internationally also). Where ICB is an inappropriate method of procurement—for example, where it is clearly unlikely that overseas suppliers or contractors would be interested in submitting bids, or where the advantages of ICB would clearly be outweighed by the administrative or financial burden involved—the first requirement is dispensed with. However, generally invitations to bid must still be advertised locally and interested foreign parties would not be precluded from bidding on the contracts in question (except where direct procurement or negotiation of contracts or force account work is permitted because of

special circumstances justifying a departure from competitive bidding procedures). This latter procedure is sometimes loosely described as "local competitive bidding," demonstrating that the essence of ICB under the Guidelines is that information on the invitation to bid should reach potential foreign suppliers and contractors, thus enabling them to participate in Bank-financed projects. Exceptional circumstances, however, may justify a departure from all competitive bidding procedures. Such exceptions will now be expressly recognized in Part B of the Guidelines and will include cases of construction by force account (where this is more economic or efficient, or is the only practical way to get a project constructed); extension of existing contracts; the need for compatibility of equipment or need for spare parts or speed; or the utilization of loan proceeds through an industrial or agricultural financing institution which relends the funds to beneficiaries in accordance with an established commercial practice acceptable to the Bank.

### Lowest evaluated bid

The Guidelines provide that in the normal case of competitive bidding the contract is to be awarded to the lowest evaluated bidder which is "not necessarily (the bid) with the lowest submitted price." In other words, price is only one of the important elements to be considered in bid evaluation, and other relevant factors such as the time of performance, the reliability of construction methods or efficiency of the equipment, and the availability of maintenance services, should normally be taken into account, too, when determining the lowest evaluated bid. The relevant factors (other than price) should be stated in the bid documents and should be expressed in monetary terms or given a relative weight. Price adjustment provisions are, however, to be completely disregarded in bid evaluation.

Bidders should normally be invited to submit bids in their own currency, in a currency widely used in international trade (except for the portion of the price which the bidder expects to spend in the borrower's country which should normally always be stated in that currency), or in the borrower's currency. All bids should be compared on the basis of a single predesignated currency (to be stated in the bid documents). Further, the rate of exchange to be used for any conversion should be the rate applicable to similar transactions on the day the bids



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Edwin G. Huffman for F&D



are opened or on the date of the award, if the exchange rate alters subsequently.

Bids must, of course, be responsive to the bidding documents, but where the invitation permits or requests alternative bids, the evaluation may become a much more difficult task, with more leeway for individual judgment than is usual. To reduce the scope for error in bid evaluation, the Guidelines state that a technical analysis is to be made for the purpose of evaluation and in order "to enable bids to be compared." Often the Bank also requires that the borrower hire suitably qualified consultants to assist in solving such problems and in administering the procurement of the goods and works to be financed from the proceeds of its loans. The Bank usually requires the preparation of a detailed report on the evaluation and comparison of the bids, the purpose of which is to set forth "the specific reasons on which the decision for the award of the contract, or rejection of all bids, is based."

### Some general principles

Based on the Bank's extensive procurement experience, the Guidelines contain a brief description of general operational principles. These include, inter alia, a list of factors to be considered in the pre-qualification procedures which are normally required for large or complex projects in order to ensure (in advance of bidding) that invitations to bid are confined to suitable contractors: the type of information that bidding documents ought to contain; the clarity of bidding documents and of conditions of contract; provisions relating to bid and performance bonds and guarantees and to retention money; the use of standards and brand names; provisions of payment; price adjustment clauses; and other technical and legal matters including *force majeure* and settlement of dispute provisions in contracts. On the latter issue, which is often a matter of great concern to foreign suppliers and contractors, paragraph 2.18 of the most recent edition of the Guidelines will provide:

"It is advisable to include in the conditions of contract provisions dealing with the applicable law and the forum for the settlement of disputes. Experience indicates that international commercial arbitration may have certain practical advantages over other dispute settling methods. Borrowers should therefore consider the advisability of providing for this type of arbitration in contracts for procurement of goods and works. The Bank, however,

should not be named arbitrator or be asked to name an arbitrator."

The brevity of the Guidelines on bidding documents and contract provisions assumes that borrowers (with whom the ultimate responsibility for procurement rests) and contractors alike have made use of the special legal expertise necessary to draft and, where necessary, negotiate the terms and conditions of the procurement documents. Some professional organizations have prepared standard forms or conditions of contract for international works or for the supply of goods. Several of these organizations have approached the Bank from time to time requesting it to recommend their model forms to borrowers, but the Bank has so far refrained from formally sponsoring any of them although there may

*"there is a real need  
for more training programs  
and facilities for officials  
of developing countries in  
the field of procurement"*

be some merit in encouraging such standardization from the point of view of procurement administration and supervision.

The Guidelines will state that "bids should not be rejected . . . solely for the purpose of obtaining lower prices, except in cases where the lowest evaluated bid exceeds the cost estimates by a substantial amount, (and that) in these latter circumstances the borrower may as an alternative to retendering and, after consultation with the Bank, negotiate with the lowest evaluated bidder (or failing a satisfactory response, with the next lowest evaluated bidder) to try to obtain a satisfactory contract." Rejection of all bids is also justified when either bids are not substantially responsive, or when there is a lack of competition. The Guidelines state that when all bids are rejected, the cause or causes justifying the rejection ought to be reviewed to consider whether revisions of the relevant specifications or modifications in the project might be desirable prior to inviting new bids.

### Conclusions

Procurement under Bank loans is an important topic for all members of the World Bank Group. For the developed countries which are interested in markets for their products, such procurement is the instrument for preserving or expand-

ing export sales on the basis of rules that afford them an equal competitive opportunity and minimize financial and other risks for the enterprises concerned. For the developing countries (the Bank's borrowers), the Bank's untied procurement approach and its almost universal membership helps ensure the best sources of supply. Various studies conducted by the United Nations Conference on Trade and Development (UNCTAD) have clearly demonstrated that restrictions placed on the choice of sources of supply by foreign assistance programs usually result in higher costs to the country that receives the aid.

The amount involved in public procurement by most governments (often representing a substantial portion of their budgets) is very considerable in both developed and developing countries alike. However, the problems associated with public procurement are more serious in the developing countries where resources are scarcer, where sufficient expertise is often lacking, and where the share of imports (whether purchased locally or bought from abroad) in total public sector procurement is normally much larger and requires additional skills that may be unnecessary when dealing with domestic and more familiar sources of supply. It is thus not surprising that the resolution of issues relating to procurement often consumes more time than any other aspect associated with Bank-financed projects; that there are several cases in which slow disbursements of Bank/IDA loan funds are caused by procurement problems of one sort or another, and that consultants hired to assist Bank borrowers on procurement problems largely come from the developed countries. As a result, there is a real need for more training programs and facilities for officials of developing countries in the field of procurement and procurement administration as well as in the related area of supply management.

An important first step in offering such training facilities was taken by the United Nations Institute for Training and Research (UNITAR) in 1972-73 through a series of five regional seminars on international procurement. However, this effort, which was carried out with the support of a Swedish International Development Assistance (SIDA) grant with marginal assistance from the Bank, appears to have come to an end. UNITAR's program report clearly confirms the need to continue and expand such training efforts, and it is to be regretted that no immediate follow-up to this pioneering initiative is in sight.

ED

# New tools for measuring government

Unsuitably formulated statistics can lead to inappropriate fiscal policies. The Fund is now organizing an effort to provide consistent and standardized statistics for the use of government decision makers.

## Jonathan Levin

In a series of regional seminars that will span Asia, Africa, Latin America, and Europe, experts from Fund member countries have begun discussions on the draft of a new *Manual on Government Finance Statistics*.

For many years the Fund has provided guidance in statistical areas related to its work. Standardized statistics on reserves and monetary aggregates have appeared in *International Financial Statistics* since 1948 and have served as a guide for national statistical and analytical practices. The Fund publishes a *Balance of Payments Manual*, which has been revised several times since its first edition in 1948, and a *Balance of Payments Year-Book* containing this data. Now, for the first time, it is extending its work of development, standardization, and publication into the additional field of disaggregated government finance statistics. Behind this expansion lies the conviction that since fiscal policy must play an important role in economic management, government operations should be measured in a manner that is consistent with financial statistics and permits comparison with other countries. Experience has shown that the use of statistics on government finance that are not suitably constructed can lead directly to inappropriate fiscal policy decisions.

## Discussion of Draft Manual

To meet the need for consistent and appropriately structured data on govern-

ment operations, the Fund, with the cooperation of the World Bank, has embarked upon a program to develop, collect, and publish such statistics both for the use of the Fund and the Bank and for the use of national policymakers and experts. One of the first tasks under this program—which is being carried out jointly by the Fund's Bureau of Statistics and Fiscal Affairs Department—has been to prepare the Draft Manual. Preparation of the draft was based on a long accumulation of experience; aggregate government finance data have appeared in *International Financial Statistics* for many years, and tables on government finance have been an integral part of Fund and Bank mission work for more than two decades. Over the past three years, moreover, special Fund missions have visited many countries to examine and discuss government finance data, and Fund staff have participated in discussions on the classification of government revenues and expenditures at meetings of the Organization for Economic Cooperation and Development.

While the *Draft Manual* is being discussed, efforts are underway to collect statistics in a questionnaire based on the *Draft Manual* and designed to tests its feasibility. For this purpose each government is being asked to designate a person as its correspondent with the Fund on government finance statistics. These correspondents, or their close associates, are completing the questionnaires and at-

tending the regional seminars convened by the Fund in Singapore, Nairobi, Latin America, West Africa, and Europe. At the Singapore seminar in February 1975, some 50 delegates from 21 countries, the Fund, and the Bank met for a week to exchange views and share experiences on questions dealt with in the *Draft Manual*. A number of concepts were sharpened for application to particular issues, and several delegations indicated that in addition to reporting to the Fund, their countries were already taking steps to adopt the proposed data systems as an aid to national policymakers. Fund staff also met with each country delegation to discuss the questionnaire and other data problems.

The *Draft Manual* under discussion at these seminars is in its English version, a 350-page volume (somewhat longer in the French and Spanish translations). It spells out the types of government activities to be measured and the means of measuring them, presents an analytical framework for the organization of these statistics, and shows the categories into which government revenues, expenditures, financing, and debt may be classified. To convey some idea of the character and objectives of the *Draft Manual* and of its relationship to other areas of economic analysis, this article briefly outlines its major organizing principles and its analytical framework.

As with any effort to collect and organize statistics, the development of government finance statistics involves a succession of alternatives and choices. Should one include government-owned enterprises? Should the statistics register expenditure at the stage of placement of government orders, delivery of merchan-



dise, or payment of funds? Should one classify a tax by the purpose for which its revenues are allocated, by whether the tax is included in the sales price, by the sector that will finally bear the tax or by the kind of transaction on which the tax is levied? To maintain a consistent course among the many alternatives, one should ideally be guided by a few basic organizing principles—enough to offer adequate guidance for the multitude of choices but not so many as to offer conflicting advice.

One may identify three basic organizing principles implicit in the *Draft Manual*:

- The institutional sector in the economy called government is to be defined not by legal or structural criteria but by the function it performs—primarily the provision of nonmarket services for collective consumption and the transfer of income for purposes of public policy, with funds coming mainly from compulsory levies on other sectors.
- To provide data for the economic and financial analysis of government and of its effects upon the economy, one should measure—not estimate or impute—the flow of payments between this sector and the rest of the economy during a given period of time.
- Because the ultimate effect of each transaction on the rest of the economy may be indeterminate or unclear, transactions should be classified not by their ultimate purpose or effect but by the immediate nature or characteristic of each transaction as it occurs.

These are not self-evident principles, and quite different organizing principles

can form the basis for other data systems. For the purposes of financial and economic analysis, however, these appear to yield the most useful results. It may be useful here to look into the meaning and implications of each of these three principles.

### Definition by function

The first principle holds that government performs a function different from that of other sectors of the economy, and it defines the coverage of government strictly on the basis of this function. The line is drawn around government not by legal or institutional criteria, nor by whether an activity is included in budget documents or receives extrabudgetary treatment, but by whether it represents the political authorities' performance of their governmental function—that is, the supply of primarily nonmarket services and the transfer of income for public policy supported mainly by compulsory levies on other sectors. This means excluding from the data all of the financial institution functions that some governments may carry out through development banks, post office savings accounts, and the like. Also excluded are all industrial or enterprise activities of a government, other than those for use within government or for sale to the rest of the economy on only a minor scale. The conduct of major industrial or commercial activities through government-owned and government-controlled enterprises would therefore be reflected not in a large government sector but in many public enterprises outside that sector. Such nonfinancial public enterprises could be grouped with government to form what may be called the nonfinancial public sector. While definition of government by func-

tion does exclude financial institutions as well as most enterprises that may appear in budget documents, it brings social security schemes within government. Though separately organized in some countries, such schemes are nonetheless similar in nature to activities carried out within government.

Another characteristic which differentiates government from other sectors is its motivation; it does not seek to maximize profit or utility for its own consumption. Government is moved by broader goals of social, political, and economic policy involving the entire economy. Because the function and motivation of government are different, government operations cannot be adequately analyzed within the same framework as other sectors of the economy. While government may borrow to meet its financial needs (as do institutions in other sectors), it does not ordinarily lend money to make a profit, but to promote policy goals. In the government sector, therefore, there is not necessarily any symmetry between the nature of changes in its financial assets and liabilities.

### Measurement of payment flows

The second principle is that compilers of government finance statistics are to measure—not to estimate or impute—the flow of payments between the government and the rest of the economy during given time periods. The reporting of payments is preferred, particularly for aggregate revenues and expenditures, because they approximate the flows of funds and resources between government and the rest of the economy, avoid problems of valuing resource flows, and correspond most closely with other financial statistics. While statistics on the actual delivery of commodities rather than payment for them have advantages for input-output analysis and measurement of production, these are far less important in analysis of the government sector than of other sectors of the economy. Most government accounts, as a result, fall closer to a payments basis than to registration of deliveries. In order to avoid the need for estimates, however, the *Draft Manual* recommends that data be used for any stage between delivery and payment that will represent the most accurate and reliable statistics available.

The gross flow in and out of government is desired. Thus, fees are not shown as negative expenditures offsetting the cost of a service, nor are the costs of collecting taxes shown as negative revenues offsetting part of the taxes collected.



There are minor exceptions, such as refunds, and corrective transactions, and there is one major exception—the operating revenues and expenditures of industrial activity carried out within government that are shown on a net basis. Because government finance statistics focus on the income, outlay, accumulation, and financing types of flows, but not on production flows that do not constitute income available to the government, they include only the operating surplus or deficit of industrial activities within government.

Government transactions are to be measured in real time—that is, when they occur—so that the data can be used in conjunction with other financial statistics for the economy. This means showing the flow of payments in and out of government at the time it actually takes place. This may differ from some government accounts which are based on the budgetary year in which the revenues or expenditures originate and not on chronological time.

Because government finance statistics seek to measure transactions between the government and the rest of the economy, they require the elimination of all transactions taking place within the government itself. Such internal transactions will frequently be included in government budgets and accounts as a means of portraying the full nature of some operations. In preparing government finance data, however, it is necessary to eliminate these transactions so as to provide a true measure of a government's transactions only with the rest of the economy.

### Classification by immediate characteristics

The third principle asserts an agnosticism or uncertainty as to the effect of government transactions on the rest of the economy. Because circumstances change and institutions vary, the effects of any government transaction on the economy cannot be determined by examining the government transaction alone. Additional study is needed on the interaction and repercussions of such transactions in the rest of the economy. The task of government finance statisticians is still to measure just what the government itself does, leaving for others the study or determination of the effects. In the classification of government activities, therefore, it is necessary to be guided by the nature or characteristics of transactions when they take place and not by their eventual effect or purpose.

### Analytical framework

This focus on the immediate characteristics of the transaction itself leads to six criteria which form the basis for the overall analytical framework laid out in the *Draft Manual*. Each transaction, the *Draft Manual* explains, can be classified by these criteria:

(1) *Does it flow to or from government?* The basic difference between transactions lies in whether they are receipts (carrying funds into the government) or payments (carrying funds out). While some data systems blur this distinction by assigning a negative sign to some items and classifying them with items moving in the opposite direction as negative receipts or expenditures, the *Draft Manual* calls for gross treatment of all except industrial transactions and certain corrective adjustments such as refunds.

(2) *Does it involve repayment?* Repayable transactions generate or extinguish a claim for repayment and are distinguished from nonrepayable transactions involving no claim for repayment. There are a number of reasons for drawing this distinction. Repayable transactions alter the financial asset or liability position of both the government and the other transactor while nonrepayable transactions do not. Asset and liability positions affect future government payments and receipts; they may influence the economic behavior of those involved by making them “feel” richer or poorer; and they may affect the behavior of other savings and investments by changing the

demand or supply for financial claims and, hence, the interest rate. How these effects operate depends upon the subsector involved, the institutional structure of the monetary system and capital markets, and other conditions and policies. Whatever the effects, however, the existence or absence of a financial asset or liability is a distinction that is apparent when the transaction takes place. Many data systems follow this distinction, sometimes referring to the contrast between nonrepayable and repayable as nonfinancial and financial or as definitive and nondefinitive.

(3) *If it is a nonrepayable transaction, is payment in return for something received—that is, is it requited?* Required transactions involve payment for a *quid pro quo*, such as goods, services, use or ownership of property, or factor services received in return. However, an unrequited transaction, while it may be voluntary or compulsory, conditional or unconditional, brings no concurrent counterpart in exchange—that is, no benefit, product, or service to the payer in return for the payment. Since product is usually measured by the payment involved, designation of a transaction as an unrequited payment implies that no product has been supplied. The required versus unrequited distinction is sometimes referred to as exhaustive versus nonexhaustive, since exhaustive payments indicate use of a product while nonexhaustive payments do not. Sometimes unrequited transactions are also referred to as unilateral, and required transfers as bilateral.

(4) *If the transaction is not repayable, is it for current purposes or for capital purposes—that is, involving goods usable for productive purposes for more than a year?* The basis for this distinction lies in the fact that use of capital goods in production for a period of more than one year affects future income and present wealth, as the capitalized present value of the future income flow. It must be recognized, however, that expenditures besides those for physical assets may also affect income growth, and capital formation cannot always be assumed to result in the highest rate of growth. Outlays for health care and education, for example, may affect the availability and quality of the labor supply. To identify all transactions affecting future income growth and not only those involving capital goods, a more comprehensive distinction between developmental and nondevelopmental transactions is sometimes advocated. Fully satisfactory criteria applicable in a broad range of circumstances have not



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Chart 1  
Classification of government transactions by criteria

		RECEIPTS		PAYMENTS	
NONREPAYABLE	Required	Current	Capital	Capital	Current
	Unrequired	Current	Capital	Capital	Current
REPAYABLE	Financial assets	Currency holdings Government deposits	Debt and equities	Debt and equities	Currency holdings Government deposits
	Liabilities	Currency issue Deposits with government	Debt	Debt	Currency issue Deposits with government

yet been evolved, however. The distinction between current and capital transactions is included in the *Draft Manual*, therefore, as a measure of the acquisition of capital assets and not as an indication of all resources devoted to growth.

(5) *If it is a repayable transaction, does it involve claims on government or government claims on others?* Such a distinction is necessary because of the fundamental asymmetry between the government's financial assets and liabilities discussed above. Because the government has access to the central bank, it need not be concerned with maintaining primary and secondary reserves of relatively liquid financial assets to call on in case of sudden need. It need not give priority, as other institutions must, to a precautionary asset position matching the maturity structure of its liabilities. Unlike other sectors, the government does not "feel" richer and act differently when its financial assets increase. It does not manage

its financial assets and liabilities position to maintain a desired liquidity at the smallest possible cost.

While government borrowing is directed toward meeting government financial needs, government lending is generally undertaken for policy-oriented purposes and not for purposes of liquidity management or earning a return. A distinction is necessary, therefore, between transactions involving a government's financial assets and those involving its liabilities.

(6) *If it is a repayable transaction, does it involve debt and equities or currency and deposits?* In both groups of transactions involving claims—those dealing with a government's financial assets and those with its liabilities—important differences separate currency and deposit transactions from those involving debt and equities. Government holdings of currency and deposits are held for liquidity purposes. They constitute working

balances and are not taken on by government for public policy purposes. Unlike other government financial assets, therefore, they belong with government liabilities as a means of adjusting the government's liquidity position.

Among government liabilities, currency and deposits have a special characteristic, because any demand, time, or savings deposits accepted by government are classified as liabilities of the financial institutions sector. Similarly, any currency issues of government are considered to represent government performance of the monetary authorities' function and are shown as liabilities of the monetary authorities. The *Draft Manual* draws a distinction, therefore, between repayable transactions involving debt and equities and those involving currency and deposits.

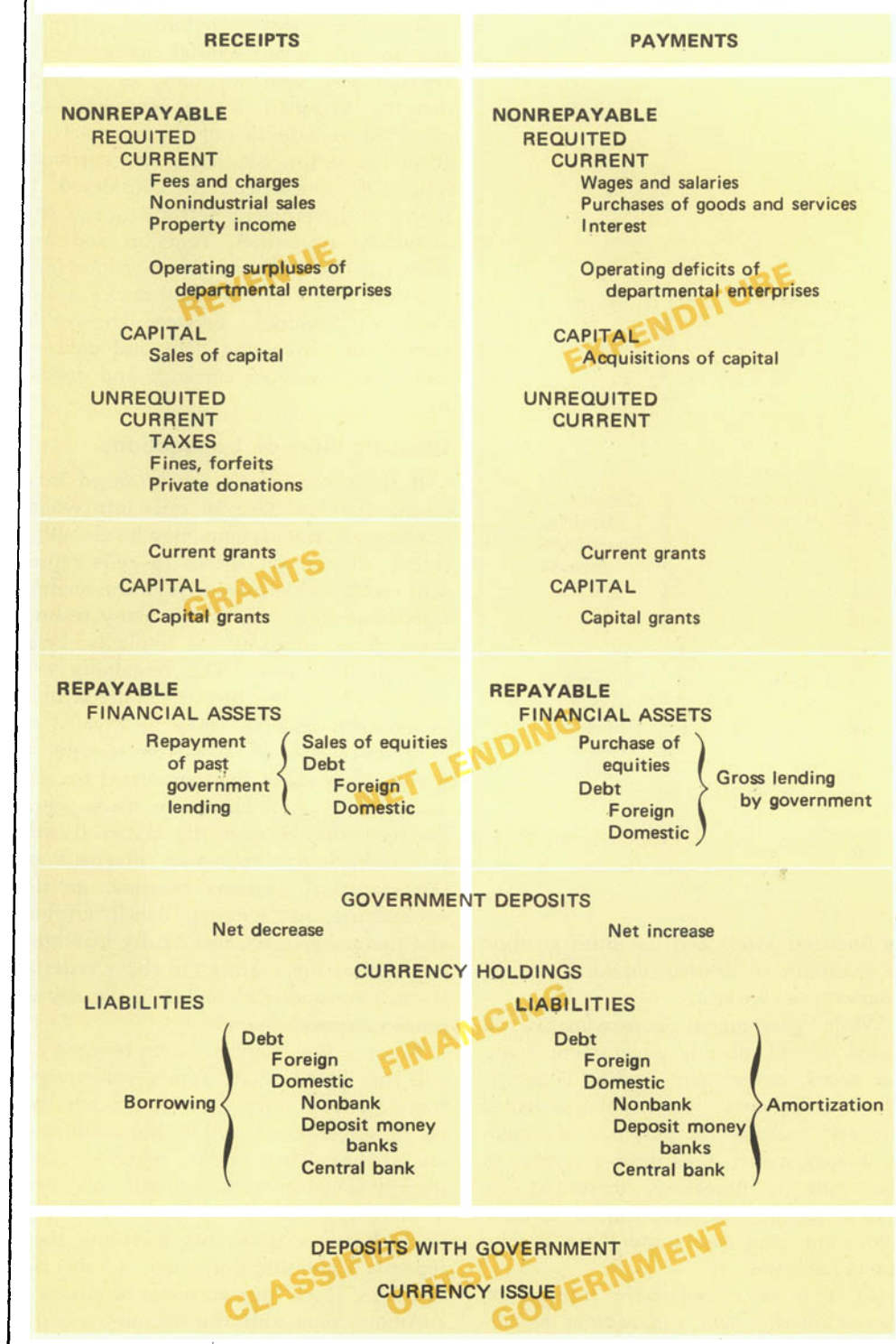
### Classification of transactions

If these six criteria are arranged in a matrix they produce 16 cells into which government transactions may be classified (see Chart 1). Of these, 15 cells represent recognizable categories in the analytical framework with which many technicians have implicitly or explicitly been working for years. The remaining cell—of current, unrequired, nonrepayable government receipts—may be divided to separate receipts of taxes from receipts of grants. Now all of the ingredients for the analytical framework are in place. They are recognizable, once the matrix format is unfolded, as the major categories of the statistical system: revenue, grants, expenditure, net lending, deficit/surplus, and financing (see Chart 2). By matching any transaction against the above criteria, it can be properly classified in the appropriate category.

Among the nonrepayable receipts, it will be noted that grants—unrequired transfers from abroad or from other levels of government within the country—are distinguished from revenues. Although they are grouped with revenues in arriving at the deficit/surplus, the distinct character of grants warrants their separate identification as a distinct "building block" for purposes of analysis.

Among repayable transactions, a separate category called net lending is set up, involving the government's financial assets other than currency and deposits. This separation reflects the basic asymmetry between lending and borrowing by governments. Net lending is separated from government financing, therefore, and in order to arrive at the deficit/surplus is grouped with outright, nonrepay-

Chart 2  
Analytical framework for classification  
of government transactions



cannot be said to be a very precise measure of government impact on monetary conditions, since this will also depend on the means by which the deficit is financed—or by which the surplus is distributed—as well as on the monetary structure and the circumstances at that time. It must be noted, too, that there are many analytical questions that this concept of the deficit or surplus cannot answer, such as government saving, government borrowing from the banking system, and the net effects of government operations with the rest of the world. But no single deficit/surplus concept can be all things to all men. In fact the variety of analytical questions raised by government operations are best answered not by any single measure but by rearrangement of basic “building blocks” of payments and receipts to meet as many analytical needs as possible.

It has been noted that the third organizing principle—classifying transactions by their immediate nature rather than by their ultimate effect—produces the overall framework of major analytical categories. Within these major categories, however, further classification is necessary to produce the disaggregated statistics upon which an adequate portrayal of government can be based. This means that one must also classify revenues, expenditures, and financing into homogeneous categories based upon the nature of the transaction itself, rather than any ultimate effect. Which characteristics can be used? The choice of characteristics in taxes is the base on which the tax is levied—property, income, sales, international trade, and so on—with no judgment on the sector, price, or income flow upon which ultimate incidence will rest. In the economic classification of expenditures, the characteristics used are some of the same criteria discussed above for nonrepayable transactions—requited or unrequited, current or capital, and so on. In the classification of expenditures by function or purpose, the immediate function or purpose is the focus—for example, sanitation, rather than its ultimate beneficial effect on health or income. In the classification of financing, transactions are arranged by the debt instrument the government sells or by the sector or class of holder with whom the debt is lodged.

#### Relations with other data systems

Delineation of the three organizing principles underlying government finance statistics can also provide insight into the relationship between these statistics and

*Continued on page 31*

able expenditures as a means of carrying out policy objectives.

As a result of this organization of receipts and payments, derivation of the surplus or deficit is equal to revenues, plus grants and minus expenditures and net lending. There are many derivations

of deficit/surplus in use today, and all seem to be controversial. This deficit/surplus, however, is meant to be a comprehensive presentation of the government's overall financial position and of its impact, in most circumstances, on monetary conditions and the balance of payments. It





# Fiscal versus trade incentives for industrialization

The quest for rapid industrialization and economic development has led many developing countries to adopt protectionist policies, which have often yielded only short-term benefits. This article examines the fiscal and trade measures that could alter this situation while promoting policies for continued growth.

**Michèle Guerard**

Many developing countries have elected to foster the growth of local industry behind the protection of high tariffs and other import restrictions over the past few decades. Recently, however, this strategy has come in for a considerable amount of criticism. An excessive emphasis on industrialization through import substitution (building up local industry behind tariff walls) has been blamed for distorting resource allocation and for widening income inequalities in developing countries, while failing to provide adequate employment. Import substitution is also blamed for generating substantial idle capacity in the industrial sector of many of these countries.

Development theorists are now urging the developing countries to shift from inward-looking to outward-looking strategies, and to place high priority on encouraging the growth and diversification of their export trade. Many are heeding the advice. But, the path they have chosen to achieve this goal has not involved the substantial readjustment of overvalued exchange rates and the dismantling of import barriers that would have been favored by free trade advocates. Instead, developing countries have increasingly adopted fiscal incentive measures designed specifically to offset the handicaps suffered by exports in economies which have a long history of protectionism.

## Trade policies for economic development

Proponents of both inward-looking and outward-looking development strategies basically agree on the need for some form of government intervention in favor of industry in developing countries. The quarrel with import substitution is not

about the ends but the means. As many theorists have pointed out, the arguments for departures from free trade are not truly arguments for protection but are merely arguments in favor of departures from strict *laissez-faire*. The correction of distortions in the operation of the market mechanism and the adjustments in the domestic cost structure which are required to stimulate industrialization are best secured, in theory, with an appropriate combination of domestic taxes and subsidies. These can be designed to attack market imperfections at their source and to align internal costs with international prices. Protection, instead, uses tariffs and other trade barriers to raise the prices paid to domestic manufacturers to the same level as domestic costs. This creates a divergence between domestic and foreign prices, which generates distortions of its own and hinders exports.

The potential use of domestic taxes and subsidies to produce essentially the same results as protection, without simultaneously discouraging exports, has been extensively analyzed in theory. The protective effect of trade barriers—the stimulus to domestic production—could be achieved on a nondiscriminatory basis through direct assistance to industry. Domestic tax instruments would then act both as substitute revenue sources (in the place of tariffs), and as a means to provide the additional fiscal resources needed to finance the industrial subsidies. The redistribution effect of import tariffs, which in fact places the burden of subsidizing domestic industry on domestic consumers, would be avoided. Instead, domestic tax policy could be designed to obtain the equivalent consumption effect—that is, the contraction of private demand required to release the amount of resources needed by the public sector—with due consideration for equity and other tax policy objectives. The balance of payments effect of protection, would be sought primarily through exchange rate adjustments. Currency devaluation

would raise the domestic prices of both imports and exports, thus drawing resources into both import-substituting and export industries, instead of placing the entire burden of balance of payments adjustment on imports (as in the case of protection).

### Gains from outward-looking strategy

Countries adopting this open strategy can theoretically expect all the classical gains from trade. These include benefits from international specialization according to comparative advantage, stimulus to efficiency as a result of exposure to foreign competition and technology, and the prospect of a world-wide market for their products. Their industries would also reap the benefits of internal economies of scale that could not have been achieved by producing only for the limited home market available under protectionist policies. Import substitution and export promotion would no longer appear as mutually exclusive industrial strategies, but would proceed simultaneously and reinforce each other.

In practice, however, there are substantial obstacles to the adoption of the non-discriminatory domestic tax-subsidy approach to industrialization in developing countries. A major obstacle is related to public finance. There are also difficulties in the use of exchange rate adjustments as instruments of balance of payments policy in developing economies.

### Fiscal problems

The fiscal reason why foreign trade taxes are universally used in preference to domestic subsidies for providing industrial incentives is that import duties are usually a prime source of government revenue in developing countries, and one of the few major taxes whose collection does not impose undue administrative burdens. Broad-based domestic taxes are considerably more difficult to administer and are not nearly as productive in the early stages of development. The simultaneous operation of a direct subsidy system for the industrial sector would presumably also place considerable strain on weak fiscal and administrative structures. In contrast, tariffs provide not only revenues for the treasury but a seemingly costless subsidy to the protected industries. These are cogent, if highly pragmatic, arguments in favor of protection as the only feasible measure at the start of the industrialization effort.

With the growth of domestic industry on the other hand, customs revenue naturally falls off with a decline in import of

consumer goods, while the domestic tax base widens. Import substitution, although it is successful in promoting industrial development, eventually costs the government its most traditional and convenient source of revenue; this loss must normally be compensated by increased domestic taxation, a usual trend in tax structure change accompanying economic development. As this evolution takes place, the fiscal argument for protection automatically loses some of its relevance. However, it may be quite some time before a domestic tax system is strong enough to generate the additional resources to finance domestic industrial subsidies on a significant scale.

### Trade factors

The second basic factor behind the intensive use of import barriers in developing countries is that, in addition to their protective function, they also bear the burden of ensuring balance of payments equilibrium. Exchange rate policy is subject to a particularly rigid set of constraints in developing economies whose exports still consist essentially of primary products. If the price elasticity of demand for these products is low on the world market, there is a terms of trade argument for keeping an overvalued rate of exchange to maximize export receipts and for using trade taxes and direct controls to adjust the balance of payments. Generally, the windfall rise in income of the primary export sector and the increase in the domestic price of imports caused by devaluation tend to generate inflationary demand and cost pressures that spread throughout the economy, preventing the desired reduction of imports and the expansion of exports in the short run.

In such a situation, trade restrictions have often been used as a substitute for

exchange rate adjustments. However, the constraints on exchange rate policy in the export economies have actually been used by Kaldor and others to make a case for differential exchange rates instead of protection. Their argument is that, if no single exchange rate can maximize primary export earnings and simultaneously provide enough inducement to import-substitution and export activity in the industrial sector to ensure overall balance of payments equilibrium, the solution would be to adopt two or more exchange rates.

Alternatively, the same results could be achieved with a combination of import duties and export taxes and subsidies designed to have the same effect as differential rates of exchange. Development theorists, such as Bela Balassa, have suggested the adoption of a basic exchange rate that would give adequate inducements to the production of nontraditional primary products, supplemented by taxes on traditional exports of primary products, as well as import tariffs and export subsidies on manufactured goods. The export taxes would be designed to take into account the lack of elasticity of foreign demand for the country's main primary products, while the import tariffs and export subsidies on manufactured goods would amount to a *de facto* devaluation of the exchange rate on industrial products only. The tariffs and subsidies would be set at the levels required to offset any overvaluation of the basic exchange rate, as well as any particular market distortions or externalities, and to ensure temporary protection of infant industries, without discriminating in favor of import substitution in place of export production.

Under such a scheme, exchange rate adjustments can again be used in balance of payments policy. While the foreign trade tax-subsidy system preserves the effective exchange rate structure for the appropriate incentive to each sector of the economy, continuous adjustments must be made in the basic exchange rate to keep pace with the rate of domestic inflation. Thus, the real value of foreign exchange will remain constant and renewed biases in favor of import substitution instead of exports will be avoided.

Within this general framework, exchange rate and foreign trade tax-subsidy measures may be viewed as largely interchangeable instruments of either industrial protection or balance of payments adjustment. The choice of a particular combination of instruments depends essentially on fiscal and other practical



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considerations. The level of the basic exchange rate itself is relatively unimportant as long as taxes and subsidies on commodity trade flows produce the appropriate effective rates, unless the exchange rate affects invisibles and capital transactions. It would be possible to add a uniform tariff on all imports purely for revenue purposes or to avoid the need for export taxes on primary products, with a correspondingly higher degree of overvaluation in the exchange rate and an equivalent increase in the level of subsidies for manufactured exports. All these steps would leave the effective exchange rates unchanged. At the other extreme, it might be possible to devalue the basic exchange rate to the point where it would provide sufficient incentive for exports of manufactured goods without the help of subsidies. Export taxes on primary products would then have to be higher, and import tariffs and quantitative restrictions would have to be more moderate, to compensate for the depreciated exchange rate.

### Compensated devaluation approach

The latter combination, which has been called "compensated devaluation," constitutes a well-defined alternative to the adoption of export subsidies in developing countries that originally took the protectionist approach to industrialization and must still resort, because of their dual economic structure, to foreign trade taxes as substitutes for exchange rate differentiation. Compensated devaluation consists of "a simultaneous and offsetting adjustment of the financial exchange rate and the trade restrictions such that all the commodity exchange rates for imports and traditional exports stay unchanged. The only net change takes place in the financial rate and in the nontraditional export rate. As a result, the latter obtain the equivalent of a subsidy." (Daniel M. Schydrowsky, "Latin American Trade Policies in the 1970's: A Prospective Appraisal," *Quarterly Journal of Economics*, Vol. 86, May 1972, p. 283.) The potentially undesirable terms of trade and inflationary effects of the devaluation do not occur, since the accompanying trade measures prevent any change in the domestic price of imports and exports (except for industrial exports, which are being encouraged) and the level of effective protection for import substitution industries is not affected because it is merely extended to the export sector.

The extent to which compensated devaluation constitutes a realistic alternative to export subsidies depends on the cir-

cumstances in the country concerned. When the industrial cost disadvantage to be overcome is very large, the size of the required devaluation may pose problems in terms of the invisibles and financial transactions. A substantial increase in export taxes on the agricultural sector may not be feasible, for political or other reasons. And holding the line on domestic prices of imported goods may in some cases require import subsidies, which could pose budgetary problems. From the fiscal point of view, however, the overall impact of compensated devaluation versus export subsidies would depend on the interaction of a number of factors, including the level and structure of imports and exports, the predevaluation level of foreign trade taxes and restrictions, and the relevant demand and supply elasticities. It is by no means obvious which of the two alternatives would have the higher fiscal cost.

Fiscal, administrative, and political factors are usually the decisive elements in the choice between export subsidies and the alternative of a straightforward multiple exchange rate policy. Although in principle they have the same effect on trade, multiple exchange rates differ from foreign trade taxes and subsidies in their practical aspects, in particular in their fiscal implications, since, under the usual institutional arrangements, only the foreign trade taxes have a direct impact on treasury revenues and expenditures. Tariffs and export subsidies might also be preferred on administrative grounds, in view of the practical difficulties of operating a multiple exchange rate system.

### Subsidies

The extension of protection from the import substitution to the export segment of the industrial sector through export subsidies avoids anti-export bias at a smaller fiscal cost than the domestic tax subsidy. It offers an intermediate approach to redressing the imbalance between import substitution and exports fostered by protection. While it does not directly affect the causes of the domestic distortions that hinder industrialization, it makes more moderate demands on the domestic tax system.

At a subsequent stage, as the fiscal and administrative operations permit it, part of the burden of industrial protection could gradually be shifted from tariffs and export subsidies to modest domestic subsidy schemes closely related to the objectives of industrial policy. The first step in this direction has recently been taken in Brazil, which had been giving

heavy emphasis to industrial export incentives and has now started to grant assistance to the relatively unprotected machinery and equipment industry on a nondiscriminatory basis by extending to domestic sales the fiscal advantages previously accorded only to export sales. Thus, the overall level of protection for the sector is increased through government subsidies rather than through tariff barriers.

Domestic industrial subsidy schemes could be limited, like the Brazilian one, to industrial activities that generate the greatest indirect benefits to the economy. A more ambitious plan could involve the creation of a labor subsidy designed to offset distortions in the industrial labor market and to promote more labor-intensive techniques of production. Tibor Scitovsky has proposed a system of industrial protection based on labor subsidies for medium-scale and large-scale enterprises, possibly ranging between 10 per cent and 50 per cent of the unskilled wage bill. The extent of the subsidy required would depend, in each country, on the difference between the shadow price of labor (its true social cost) and the prevailing level of industrial labor costs. This subsidy could still be combined with a small, industrial tariff designed to provide some protection to firms too small to be included efficiently in the labor subsidy scheme and, if necessary special infant industry protection for other well-defined sectors.

Protection is also used sometimes to compensate industry for the poor quality or for the absence of public infrastructure and services in developing countries. This is still another area where potential trade-offs exist between import duties and export subsidies for industry, on the one hand, and domestic government expenditure, on the other hand. In the Philippines, for instance, export manufacturers establishing their plants in the less developed sections of the country are allowed to deduct from their taxes the full amount of their expenditure for construction and for maintenance of the necessary public infrastructure. Although undertaken on private initiative, such infrastructure is in fact a public investment, fully financed with tax money and transferred to the state upon completion.

### Export incentives

Export subsidies are regarded by many theorists as having a definite role in the industrial and trade policies of developing countries. Since they are negative export taxes, export subsidies have essentially

the same incentive effect on exports as protective tariffs have on imports. The same arguments that can be advanced to justify government intervention to protect industry in the domestic market may be used in defense of the production of goods for the export market.

Some form of export subsidization is also likely to be required to overcome the illusion of inefficiency that may affect the industrial sector in a protectionist setting when it confronts the world market. This illusion of inefficiency, as pointed out by Daniel Schydrowsky, stems from making international price comparisons at conversion rates that overstate the domestic costs and understate the domestic currency value of exported production. The growth of manufactured exports may also help domestic producers to become accustomed to external competition and may permit a more economical scale of operation, thus also contributing to the relief of the efficiency handicap associated with import protection. In Brazil, for instance, within a few years of the adoption of an export incentive system, manufacturers testified to the efficiency effect of export promotion policies by stating that, if government incentives were abolished, exports would not decline to preincentive levels, owing to the economies of scale realized. The growth of production for both domestic and export markets had reduced unit costs to such an extent that some producers had become competitive, even without the fiscal incentives.

Furthermore, depending on the size of the domestic market and the nature of the resource base, the best infant industry opportunities for some countries may well occur in export sectors rather than in import substitution sectors. It has also been argued that the economic costs of policies biased in favor of export promotion may be smaller and that the pay-offs may be higher than those of one-sided import substitution strategies.

Except in a few special cases, such as Hong Kong and Singapore, the pattern of industrialization in developing countries has always involved an initial phase of more or less intensive import substitution. The neglected export market becomes the focus of attention only at a later stage. Export growth comes about, in part, as the result of a prior buildup of industry behind protective barriers. A "spill-over" of import substitution into exports eventually takes place, after the exhaustion of the more immediate import replacement opportunities in the domestic market. At that point, export promotion often appears more promising in the

short run, than the second phase of import substitution (in the intermediate and capital goods sectors), both as a source of continued growth, and as a means of increasing foreign exchange availability. Steps are then taken to remove the roadblocks that stand in the way of exports and supply manufacturers and to give them inducements to explore foreign markets. A number of semi-industrialized countries have now embarked on this phase, and export incentives accompanied by attempts to rationalize exchange rate

*"the export incentive policies of the developing countries have thus far been characterized by a fair degree of chaos"*

and import policies have become an important element in the transition to more outward-looking strategies.

### **Practical problems seen**

On the whole, however, the export incentive policies of the developing countries have thus far been characterized by a fair degree of chaos. This is due, in part, to the haphazard and piecemeal fashion in which these policies have evolved over the years; that is, in a somewhat experimental manner in the attempt to offset the increasingly serious distortions spawned by protectionism. Another factor has been the international disapproval of export subsidies, accompanied by the fear of retaliation by importing countries. Export incentive measures bear a stigma that is not attached to other government trade interventions. This explains why export incentives rarely take the form of outright subsidies, assuming instead a number of indirect forms which may sometimes be dictated by reasons of domestic practical convenience or political expediency and which also fulfill considerations of international acceptability and foreign market reaction.

The array of techniques that have been used by developing countries to encourage industrial exports is considerable. Some of the oldest devices employed to offset the anti-export bias of prevailing policies operated directly through the trade and exchange control system—such as special exchange premiums or bonuses for exporters, or straightforward multiple exchange rates. Import entitlements have also been used, ostensibly to provide

manufacturers with scarce materials needed for export production. This use was equivalent to granting exporters a subsidy, except that the government did not need to finance the subsidy directly, merely transferring to exporters part of the gains normally accruing to importers as a result of quantitative restrictions and exchange controls.

At present, the most widely used export incentives are fiscal incentives. The degree to which they are accepted by the international community is somewhat blurred, and the basis for the approval or disapproval of certain fiscal devices is controversial. There is also a difference between the international code of conduct and its application, since some measures, although condemned, are tolerated in practice. Fiscal concessions have the advantage of using the existing tax administration system as a vehicle for their implementation, and they also offer a wide range of possibilities for pursuing particular policy objectives. A variety of tax concessions, rebates, and credits can be used to subsidize exports in a more or less covert fashion. They are often supplemented by a battery of credit subsidies, in the form of preferential facilities by official financial institutions, export credit insurance at subsidized rates, and government exchange guarantee programs. All of these measures are borrowed from the developed countries which resorted to them earlier and continue to use credit incentives much more intensively than the developing world. Finally, governments usually grant varying degrees of assistance to exporters in the form of free market information and sales promotion services.

The overall impact of the various export incentive programs in each of the developing countries is not easy to assess. Many incentives are difficult to quantify, since their costs and benefits are difficult to measure. However, in the same way as indiscriminate import protection can be expensive and wasteful of the economy's resources, export subsidies that are excessive or ill-designed can be responsible for costly distortions in the allocation of resources and undesirable distributional biases, while their fiscal and administrative cost may be out of proportion to their benefits. The costs, benefits, and potential biases introduced by export incentives vary widely from one technique to another. Only a detailed analysis of the different devices could throw some light on a subject that has so far benefited from relatively little systematic thinking.





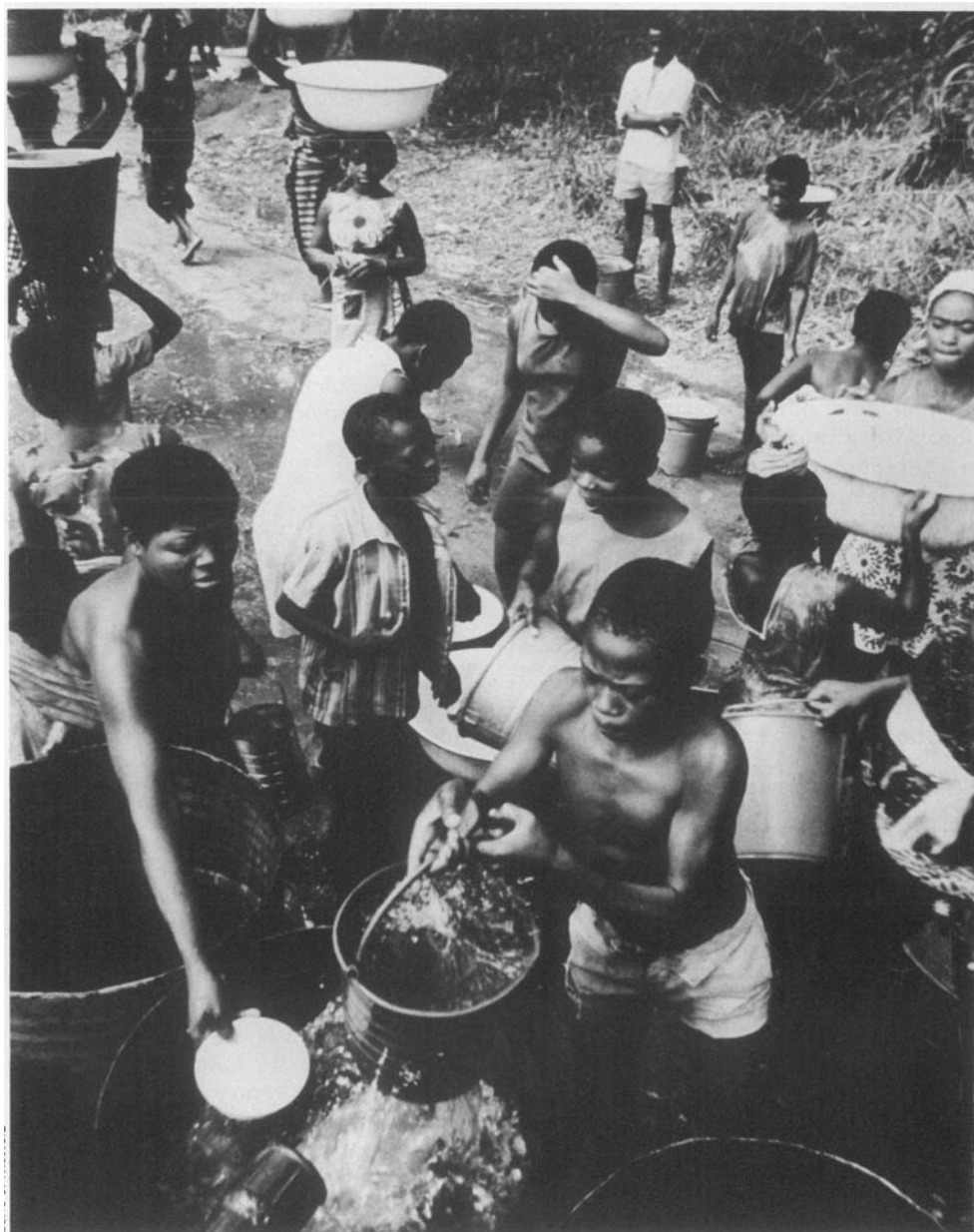
## Changes in emphasis in rural sector lending

Changes in the Bank Group's development philosophy have led to a greater emphasis on lending for agricultural and rural development in the developing countries. The authors outline these changes and their effects.

**David J. Bates and Graham F. Donaldson**

In the past few years the World Bank Group has channeled some 20 per cent of its annual lending into agriculture and rural development. This is in addition to the Bank's indirect contributions through its technical assistance programs, through training by the Economic Development Institute, and through its support to international agricultural research centers. In this way, the Bank influences development of the rural sector beyond its own projects. This is the result of a conscious shift in Bank policy over the past decade resulting from, first, a different perception of development and its underlying processes, and, second, an awareness of the growing pressures on agriculture and rural sectors in developing countries.

In its early years the Bank was strongly oriented toward investment in basic infrastructure (ports, roads, dams and irrigation works), because of the general view that developing economies lacked the infrastructure to allow them to absorb investment capital productively and that infrastructure investment was therefore the first priority. Subsequently, the emphasis shifted toward lending for modern sector development (mainly urban based heavy industries). This reflected the belief that rapid industrialization was the key to economic growth. More recently there has been increasing recognition that absorptive capacity can be increased by technical assistance (especially institution building and manpower training) and that the growth of gross national product (GNP) is a necessary but not sufficient condition for successful development. The requirements for achieving GNP growth are now considered to include in addition to an in-



Water supply, as in this African village, is an integral part of rural development projects.

Table 1  
World Bank lending: all sectors and agriculture  
fiscal years 1948-74  
(Amounts in millions of U.S. dollars)

Fiscal years	Lending for all sectors by IBRD and IDA	Agricultural lending by IBRD and IDA	Agricultural lending as percentage of total lending
1948-63	5,322.0	451.4	8.5
1964-68	5,030.3	620.8	12.3
1969-74	17,263.0	3,544.8	20.5
Total	27,615.3	4,617.0	16.7

Source: World Bank records, Programming and Budgeting Department

Table 2  
World Bank lending for agriculture by region  
(Amounts in millions of U.S. dollars)

Fiscal years	Eastern Africa	Western Africa	Asia	EMENA	LAC	Total	As percentage of total lending
1948-63							
Amount	44.7	—	203.8	117.6	85.3	451.4	9.8
Per cent	9.9	—	45.2	26.1	18.9	100.0	
1964-68							
Amount	33.0	18.9	273.1	65.0	231.7	620.8	13.4
Per cent	5.3	2.9	44.0	10.5	37.3	100.0	
1969-74							
Amount	405.6	217.6	1,332.9	808.8	779.9	3,544.8	76.8
Per cent	11.4	6.1	37.6	22.8	22.0	100.0	
Total							
Amount	483.3	235.6	1,809.8	991.4	1,096.9	4,617.0	100.0
Per cent	10.5	5.1	39.2	21.5	23.7	100.0	

Source: World Bank records, Programming and Budgeting Department.  
Note: Percentages rounded.

creasing flow of capital, political stability, availability of technology, manpower training, and effective market organization. Also, a broader view is now accepted of the appropriate composition of development benefits, which includes employment creation, equitable income distribution, and improved living conditions. The extension of this approach to many client countries—notably those with limited borrowing capacities—has been facilitated since 1960 by the availability of funds from the International Development Association (IDA).

### Sectoral emphasis

The proportion of Bank Group funds going to the rural sector has increased from 8.5 per cent for 1948-63, to 20.5 per cent for 1969-74 (see Table 1). Since the annual lending of the Bank has also expanded substantially—by some 240 per cent between the periods 1964-68 and 1969-74—the amounts allocated to agricultural projects have greatly increased. This reflects the Bank's deepening involvement in rural sector development, although the amount involved remains only marginal in terms of the total investment in the rural sector of developing countries—probably no more

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than 2 to 3 per cent—and is minimal in terms of the investment that is needed. It is significant that of all rural sector lending by the Bank over 75 per cent has been in the last six years (see Table 2).

### Regional orientation

The expansion of agricultural lending has been accompanied by a changing regional allocation, as shown in Table 2. In particular, lending to Eastern and Western Africa and to Europe, the Middle East, and North Africa (EMENA) regions increased throughout the 1960s. The absorptive capacity of these countries expanded with the increase in technical assistance, and more emphasis was placed on small farm development, as opposed to large-scale plantation and ranch investment. This was accompanied by a substantial increase in the number of Bank agricultural staff working in these regions. By contrast, the proportion of agricultural lending to Latin America and to the Caribbean (LAC) has declined from 37.3 per cent to 22.0 per cent, partly due to changes in the lending activity of the Inter-American Development Bank in Latin America, and to the larger flow of funds to Eastern and Western Africa. The proportion going to Asia has also declined, although total Bank Group lending to this region has still more than quadrupled between 1964-68 and 1969-74. This decline reflects in part the trend away from emphasis on heavy infrastructure especially hydroelectric power, toward a wider range of projects.

### Project diversification

The shift from large-scale capital intensive projects toward funding the concomitants of a science-based agriculture—research and extension, new seeds, fertilizers, irrigation facilities, credit and marketing programs, and other services—is reflected in the pattern of subsector lending (see Table 3). Although lending for irrigation development has declined from 77.7 per cent in 1947-63 to 33.2 per cent in 1969-74, it remains the largest single category, reflecting the importance of irrigation in the densely populated land-scarce areas of Asia and the Middle East. However, recent irrigation projects show a trend toward small scale schemes involving lift pumps and tubewells, as well as the development of other aspects of water resource use, such as ancillary roads, research farms, farmer credit, and related services, to take full advantage of the improved water supply.

Over the last few years new projects have involved the financing of fisheries,



forestry, agro-industries, and area development projects. In 1974, for instance, the Bank made a \$6.5 million credit to Indonesia for a fisheries project, designed to increase production for both domestic consumption and exports and to increase the employment opportunities and incomes of fishermen and their families. A joint Bank/IDA project amounting to \$13.5 million in the Mangoro region of Madagascar involves planting 35,000 hectares of pine trees in presently unutilized areas that are unsuitable for livestock

tural lending goes to on-farm investments, largely under agricultural credit and livestock projects, which finance practically all aspects other than the transfer of existing resources such as land. The principal items include groundwater development, drainage, pasture improvement, tree-crop planting, livestock purchase (mainly cattle), farm machinery, buildings, fencing, on-farm processing, and storage facilities. Investments are also made in the essential prerequisites for making these programs effective, such as technical advi-

ary so that they can be extended to other areas, given the availability of additional resources.

The "new style" projects are intended to reach large numbers through area development, settlement, irrigation, and land improvement schemes. Most of the projects have an agricultural base and involve technological change—frequently the introduction of water, credit, improved seed, and fertilizer. Many of the projects also include some diversification in agricultural production. The area de-

Table 3  
World Bank lending for agriculture by subsector  
(Amounts in millions of U.S. dollars)

Fiscal years	General agriculture	Agricultural credit	Area development	Fisheries	Irrigation	Livestock	Agro-industries	Perennial crops	Forestry	Agricultural research	Total
1947-63											
Amount	43.9	20.2	19.7	*	350.9	7.0	4.7	*	5.0	*	451.4
Per cent	9.7	4.5	4.4	*	77.7	1.6	1.0	*	1.1	*	100.0
1964-68											
Amount	*	84.6	64.7	22.2	276.0	145.8	19.2	8.3	*	*	620.8
Per cent	*	13.6	10.4	3.6	44.5	23.5	3.1	1.3	*	*	100.0
1969-74											
Amount	52.5	639.7	359.9	44.1	1,178.4	633.5	243.6	344.0	36.4	12.7	3,544.8
Per cent	1.5	18.1	10.2	1.2	33.2	17.9	6.9	9.7	1.0	0.4	100.0
Total											
Amount	96.4	744.5	444.3	66.3	1,805.3	786.3	267.5	352.3	41.4	12.7	4,617.0
Per cent	2.1	16.0	9.6	1.5	39.1	17.0	5.8	7.6	1.0	0.3	100.0

Source: World Bank records, Programming and Budgeting Department  
Note: Percentages rounded.  
\* No funds allocated for this subsector.

and crop production. The five-year afforestation program includes a survey of the area to be planted, land preparation, establishment of nurseries, fertilization, planting, weeding and disease control, and construction of about 56 kilometers of service roads. It is anticipated that the project will provide direct employment for over 1,600 laborers. In 1974, the IDA concluded a \$13 million credit agreement with India, to improve the apple processing and apple-marketing industry in Himachal Pradesh. This will involve introducing technological innovations in processing, packing and grading fruit, establishing a commercially oriented marketing organization, and making infrastructure improvements capable of handling 55,000 tons of apples—25 per cent of estimated production on completion of the project in 1978. The Bank loaned \$6 million to Brazil in 1973 for a \$11.5 million scheme to settle 5,200 families on 100-acre farms in the northeastern State of Maranhão for increasing agricultural output and employment. All of these moves reflect a broader view of what comprises agriculture, together with an increased preparedness by the Bank to finance shorter-term inputs.

Almost 40 per cent of Bank agricul-

tural lending goes to on-farm investments, largely under agricultural credit and livestock projects, which finance practically all aspects other than the transfer of existing resources such as land. The principal items include groundwater development, drainage, pasture improvement, tree-crop planting, livestock purchase (mainly cattle), farm machinery, buildings, fencing, on-farm processing, and storage facilities. Investments are also made in the essential prerequisites for making these programs effective, such as technical advi-

sory services, feeder roads, distribution networks, collection systems processing facilities, storage capacity, and marketing arrangements. Frequently, an agricultural research component is included in these projects.

The Bank also helps promote the activities of the ten or so international agricultural research centers. It acts as chairman for the Consultative Group on International Agricultural Research for which it provides a secretariat and some funds.

### New style projects

The change in emphasis and the aim of reducing poverty have resulted in the emergence of "new style" projects. The main elements of these projects are:

- They are designed to benefit large numbers of the rural poor, while earning an economic rate of return at least equal to the opportunity cost of capital.
- They are comprehensive in their approach to small scale agriculture and provide for a balance between directly productive and other components, such as education, health, and water supplies.
- They have a low cost per benefici-

development projects often have a social component—health services, basic education, and water supplies. Whenever possible, cost has been held down through low cost delivery systems and use of intermediaries, such as farmers' associations, cooperatives, and other groups which can reduce some of the overhead costs. Many projects include innovative approaches to project design and implementation. Some examples are the IDA credit to Upper Volta which established a Rural Development Fund to finance the improvement of water supplies and livestock production of nomadic tribesmen; the Korea Seeds project, which finances establishment of a modern seeds industry in that country, including the capacity to undertake continuing research into a range of crops, in order to promote broad based income increases for a large group of farmers at very low cost; the Keratong Land Settlement project in Malaysia, which includes financing of the construction of project towns in the settlement area; and the Kigoma project in western Tanzania, which involves the use of a regional government authority for project management and includes agricultural and village services.

There has also been support for con-



Table 4  
World Bank lending for agriculture by income groups  
fiscal years 1964-68 and 1969-74  
(Amounts in millions of U.S. dollars)

Per capita GNP of borrowing countries	Fiscal years 1964-68				Fiscal years 1969-74			
	Agricultural loans by IBRD and IDA		As percentage of agricultural loans		Agricultural loans by IBRD and IDA		As percentage of agricultural loans	
	Number of projects	Amount of loan	Number of projects	Lending	Number of projects	Amount of loan	Number of projects	Lending
Less than \$150	9	139.9	20.5	22.5	101	1,354.2	43.7	38.2
\$151-\$375	18	175.2	40.9	28.2	78	1,068.3	33.8	30.1
\$376-\$700	13	253.3	29.6	40.8	30	781.0	13.0	22.1
Over \$700	4	52.4	9.0	8.5	22	341.3	9.5	9.6
Total	44	620.8	100.0	100.0	231	3,544.8	100.0	100.0

Source: World Bank Atlas, 1973 and World Bank Annual Reports  
Note: Percentages rounded.

tinuing programs of rural development. These include the Mauritius Rural Development project supporting the rural works program there; a project supporting the Government's remedial program for drought-prone areas in India; and the Mexican Government's Program for Integrated Rural Development. Many of these are nation-wide programs or have the potential to become nation-wide programs.

### Institutional arrangements

Having recognized the importance of delivery systems and institutions, and the difficulties in organizing these for large numbers of small farmers, the Bank Group is giving greater attention to these problems. More care is being exercised in fostering the establishment of the local institutions responsible for implementing rural based projects. A high degree of government commitment is being made a prerequisite to lending, which often involves prolonged dialogue with the national authorities.

Since institution building has long been an integral aspect of its agricultural projects, the Bank Group has participated in the creation of new farm credit institutions and in the rehabilitation of existing ones. It is increasingly ready to finance lending through cooperatives, farmers' associations, and other existing channels, as well as lending to tenants, farmer groups, agricultural contractors, and others apart from individual owners, in order to increase the range of rural people with access to credit facilities and related services. The Bank also stresses the need for terms of lending and interest rates that take account of the production needs and repayment ability of the farm-level borrower.

Land settlement is supported whenever unexploited land is made available. This has been done most recently in Colombia, Papua New Guinea, and Tanzania. The Bank is prepared to finance the concomitants of land reform wherever governments see fit to initiate such a program, providing that the program meets certain minimum requirements.

A series of comprehensive area development projects have been supported, some of which have involved changes in land holding patterns, especially in Africa. The Lilongwe project in Malawi and the Wolamo project in Ethiopia were among the first of a new trend toward integrated smallholder development programs organized on a regional or sub-regional basis, or around the production of a specific cash crop, such as tea in Kenya, Uganda, and Tanzania. They have involved a large degree of innovation and point the way toward likely developments in the future. The Bank has clearly outlined all these policy objectives in the recently published policy papers on agricultural credit, land reform, and rural development.

### Target groups

The Bank's rural sector lending is increasingly moving toward projects that reach the poorest groups and largest numbers of people. More emphasis is being placed on the lower-income areas; lending to countries with per capita annual incomes less than \$150 has increased sixfold and almost doubled in proportion (see Table 4). This is in keeping with the policy aims outlined in Bank President McNamara's address in 1973 at the Annual Meeting of the Bank and the Fund in Nairobi "to direct an increasing share of our lending to programs which

will directly assist the small farmers to become more productive." This type of lending is especially dependent on the availability of IDA funds, since most poor people live in developing countries where repayment of foreign loans is a real burden. The Bank estimates that agricultural projects had over 10 million direct beneficiaries in 1973-74, including the dairy project in India with some 2.5 million direct beneficiaries.

The emphasis on reaching the poor is based on several realizations. First, that GNP growth was not benefiting the growing masses of people in the rural sector and that the supposed "trickle down" of development effects from GNP growth was largely illusory. Second, many countries were experiencing population pressure and employment problems in rural areas. Third, smallholdings comprised a ready combination of resources (land, labor, and often some capital), and smallholders were responsive to economic incentives and achievable goals.

Among the things needed were an appropriate science-based smallholder technology, the service systems to support it, and an adequate rural infrastructure. The new orientation toward rural development, which aims at providing these ingredients, has resulted in a new concern with agricultural research, increased attention to technical assistance activities, and the need for new Bank procedures for project formulation and appraisal and for supervision and implementation.

The need for new procedures is being explored through the activities of a rural development unit which is involved in developing projects of an innovative kind. Such projects necessitate more careful preparation and attention to problems of implementation as the human factor grows in importance.

# Some economic concepts and policy issues in developing countries

This article examines some of the economic concepts and issues confronting economic policymakers in developing countries. While many of these concepts and issues are common to developed countries, considerable differences arise mainly from the way they are manifested in the context of economic problems.

## U Tun Wai

How do the economics of developing countries compare with those of developed countries? The answer depends largely on the definition of economics.

If economics is the study of economies, then each country's economic problem is unique and no generalization can be made. But if one defines economics as a field of study which attempts to derive universal principles regarding the allocation of scarce resources toward competing ends, then one would have to conclude that these principles of economics are applicable universally. Nevertheless, one could still discuss the relevance of a given set of principles to a particular situation.

The confrontation of a given theory with economic reality helps to determine its relevance. It also enables economists to improve a theory and make it more applicable to developing countries. From this point of view, there is scope for discussing economic concepts and issues which may be different from those in developed countries. Two further points will help to clarify the relationship between concepts and policy issues and between theories and economic realities.

The first point concerns the relevance of macroeconomic models for developing countries. Most macroeconomic models, built with developed countries in mind, are designed to approximate reality. Therefore, there is bound to be a gap ( $G$ ) between the model ( $M$ ) and reality ( $R$ ). The relevance of the model becomes

greater when  $G$  approaches zero or when the difference is one of degree and not of kind. The gap will be large if the assumptions of the model are not realistic. Since economic reality is different for developing and developed countries, one should not be surprised if the gap between the model and reality is greater for developing countries than for developed countries. Even for developed countries, when policy issues are under consideration one needs complicated models. R.G.D. Allen in the preface to his book, *Macro-Economic Theory: A Mathematical Treatment* (1968), states: "The models considered here, despite their formidable appearance at times, are many stages removed from policy applications. They attempt to explain how things work in precise terms. But just because of their precision, they are not easily used in any consideration of how the working of the economic system should be viewed in practice, when the strategic variables change from one situation to another. Moreover, in order to obtain precision, the models are drastically simplified to keep down the number of variables and parameters."

The second point may be made through an analogy with medicine. Even though human beings have the same anatomy and physiology, tropical medicine is studied as a separate field of specialization. For similar reasons, development economics is studied separately in many universities throughout the world.

Thus one would expect to find economic problems in developing countries very different from those in developed countries. This analogy also helps to explain why certain parameters and the strength of some variables may be different in the two types of countries.

The techniques of economic analysis that are universally useful include *ceteris paribus* (other things being equal), marginal analysis, and trade-offs. *Ceteris paribus* enables the economist to break up a complicated problem into its components and into manageable units. Marginal analysis helps to show the policymaker the additional effort needed to solve an economic problem. Trade-offs between conflicting objectives and between alternative policy instruments highlight the nature of economics. Bearing these points in mind, we examine below some of the important economic concepts and issues facing policymakers in developing countries, without relating them to specific theories or to particular economic situations. There are other important problems which are not dealt with in this article, for example, the need to develop domestic financial markets and bring about social and other institutional changes to obtain a high rate of economic growth.

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## CONCEPTS AND ISSUES AT THE NATIONAL LEVEL

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### Per capita income

The one measure used widely by economists and policymakers to indicate material progress is per capita income (national income divided by total population). When this measure is deflated by prices to give real per capita income over time in a given country, one cannot quarrel with this indicator. But when it is used to make international comparisons,

there are many pitfalls because the exchange rate does not measure the purchasing power of currencies for goods and services that are not internationally traded. Then, again, consumption patterns and needs between countries may be so different for climatic, social, and institutional reasons that per capita income may be a poor measure of economic welfare—not to mention the social costs of pollution, overcrowding of cities, and other factors which are not taken into account in computing national income.

Despite these shortcomings in evaluating material progress, policymakers in developing countries place great weight on development plans to increase total output and to reduce the so-called gap between standards of living in developing and developed countries. The first objective is desirable if it is regarded only as a first approximation of what a country really wants and if other equally desirable social objectives, such as more equal distribution of income, are not disregarded. The second objective is desirable, politically speaking, but it will be very difficult to reduce the gap since the standards of living in developed countries are rising rapidly.

## Unemployment

Two views can be taken of the unemployment problem in developing countries. One is to regard the problem in the same way as in developed countries—that is, to be very concerned with it either in the form of open unemployment or of disguised unemployment. Consequently, considerable impetus must be given in development plans to increasing employment. The other view would be to point to the evils of unemployment but to put less pressure on the government to solve this problem on the grounds that the family is still an economic unit in developing countries and provides private social security. Both views are valid—the former for urban areas and the latter for rural areas; the relevance of the two views depends in part on whether the country is generally overpopulated (as, for example, India and Bangladesh) or on whether it is not overpopulated (as many African and Southeast Asian countries).

The availability of unemployed labor is both a challenge and a possibility for more rapid growth in developing countries, says W. Arthur Lewis (*"Economic Development with Unlimited Supplies of Labour," The Manchester School*, May 1954). However, Ragnar Nurkse (*Problems of Capital Formation in Underdeveloped Countries and Patterns of Trade*

and *Development*, 1967) believes that there are a number of problems to be overcome before excess workers in rural areas can be put to work on new investment projects in urban areas, including the cost of transporting food from farms to projects and the need to give tools to workers on these new investment projects. In short, any sizable reduction in unemployment depends on additional free resources to finance investment for infrastructure and to train unemployed workers.

Besides the question of supply of labor, there is the problem of factor proportions in developing countries, which has an important bearing on the choice of projects

*"there should be more research and development expenditures for capital saving innovations"*

and the relative use of labor and capital. Since developing countries have to import capital equipment it may be desirable to choose more labor intensive projects to save foreign exchange and give employment to nationals. Furthermore, since these innovations are based on relative prices of labor and capital in developed countries, the latest machinery is not necessarily the best choice for developing countries. Hence, there should be more research and development expenditures for capital saving innovations specially suited to their needs. If the innovations can be both capital and labor saving, as for example improved higher yielding

seeds suited to the local climate, then the needs of developing countries would be well served.

Sometimes the unemployment problem in developing countries is said to originate from structural factors which are nonexistent in developed countries. A number of explanations have been given for the existence of structural unemployment in developing countries, many of which are related to structural disequilibrium at the factor (input) level. For example, market imperfections, technological restraints, and overpopulation have been stressed by R. S. Eckaus, (*"The Factor Proportions Problem in Underdeveloped Areas," in American Economic Review*, September 1955). The policy implications of this analysis for developing countries is that one needs to improve the institutional framework and adapt existing technology to developing countries.

## Nonmonetized sector

A nonmonetized sector exists in developing countries because a certain part of output produced by the villagers is purely for home consumption. It can also exist when goods are bartered rather than bought with money. The size of the nonmonetized sector is believed to be important in a large number of developing countries, even though it has never been measured accurately. Such a sector also exists in developed countries—for example, when wives provide services in the home without direct monetary gain—but it is generally believed to be less important than in developing countries.

Should the authorities take this sector into account in planning? Should they take steps to monetize the sector gradually or merely ignore it? Most economists would say that it cannot be ignored and that if developing countries are to grow rapidly one must integrate such a sector into the rest of the economy, not only to motivate villagers to produce more and be more responsive to the objectives of the plan but also to enable the government to tax more heavily. Further, growth can be more rapid if there is specialization and division of labor. What better way is there to do this than to make the villager more specialized, selling his product to the market and buying practically all his needs from the market?

If the objective is growth per se and not stability of income, this view is valid. The production of goods for home consumption provides the villager with his own built-in stabilizer except when there



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Edwin G. Huffman for F&D



are widespread droughts or floods. Therefore, perhaps, what is needed is not to reduce the size of the nonmonetized sector absolutely, but only relatively, by increasing the monetized sector. This can be done only if the villager will either work longer hours or use more capital to produce goods for the market without diminishing production for home consumption.

## CONCEPTS AND ISSUES AT THE INTERNATIONAL LEVEL

### Terms of trade

In the international field, terms of trade is perhaps the most widely used concept by policymakers, partly because it is relatively easy to understand and partly because it is convenient to explain difficulties in a country's balance of payments. The technicalities of terms of trade are the same for both developed and developing countries. But owing to the greater sensitivity of prices of raw materials over the business cycle of developed countries, the greater dependence on fewer export commodities by developing countries, and the importance of international trade to growth, this subject has been associated more with the problems of developing countries than those of developed countries.

By the terms of trade is meant the ratio of export prices to import prices over time with a fixed base year. Terms of trade are said to improve when export prices rise more rapidly (or fall less rapidly) than import prices or when export prices rise while import prices fall. When this occurs a country is able to obtain a larger volume of imports for a given quantum of exports. There is a deterioration in the terms of trade when the reverse happens.

There are a number of technical questions before terms of trade can be used as a basis for policymaking. First, the terms of trade should be measured in foreign currency prices; they can also be measured in local currency prices provided the conversion factors are the same for both exports and imports. Complications arise when there is a marked shift over a period in the commodity mix of exports and imports. Then there is the question of the choice of the base year. If the chosen year is one when export prices are relatively high, then the terms of trade will appear to be unfavorable in the subsequent period. If export prices are low in the base year, then the terms of trade will appear unrealistically favor-

*"cartels for other commodities are not likely to have the same success as OPEC because there are close substitutes for other raw materials"*

able. While policymakers may have special reasons for choosing one year over another, one could partly avoid the base year problem by fitting trend lines to export prices and import prices and then compare the two trends. Even here, there is the question of what overall period one should consider. How far back should one go to make such a comparison?

The policy objective of not wishing to allow a country's terms of trade to deteriorate is commendable but the means to achieve this objective are neither simple nor clear cut. Judging from innumerable speeches at international conferences, policymakers in developing countries rely a great deal on urging their more developed trading parties to maintain the demand for raw material exports from their countries, while taking appropriate steps to prevent the prices of industrial products from rising. Such exhortations have some propaganda value but have not prevented terms of trade from fluctuating or deteriorating according to changes in market conditions.

More recently, the oil producing countries have succeeded in improving their terms of trade through restricting output and raising the export price of oil. Their success has resulted partly from the solidarity shown by the OPEC (Organization of Petroleum Exporting Countries) countries and partly by the inelastic demand for oil, at least in the short run. While other developing countries would like to take similar measures to improve their terms of trade, cartels for other commodities are not likely to have the same success as OPEC because there are close substitutes for other raw materials.

### International inflation

In the 1950s and early 1960s it used to be thought that mainly developing countries suffered from chronic inflation. During the past ten years, inflation has become a world-wide phenomenon, and there are many developed countries, such as Italy, Japan, the United Kingdom, and the United States, where the inflation level is now measured in double digits (that is, above 9 per cent a year), and ex-

ceeds that of many developing countries. This phenomenon is all the more remarkable when we consider that most industrial countries experienced a long period of about two decades of relative price stability and growth. The recent period of inflation is different from some of the earlier ones because price increases are accompanied by declining output and rising unemployment, and hence the term "stagflation."

While it is not our main concern to analyze the causes of this change in the world situation, all periods of inflations have excess demand situations with some cost-push elements; some of the basic reasons might be

- a slowing down of the rate of technical advance in industrial countries which formerly helped to raise labor productivity to match the demand for higher money wages,
- pre-empting by governments in developed countries of bigger shares of the gross national product for government consumption and national defense, financed to a large extent by central bank credit,
- the rapid expansion of output in industrial countries leading to a world-wide boom in prices of primary products which, in turn, through the foreign trade multiplier, increased imports of industrial products by the developing countries,
- the breakdown of the built-in safeguards among industrial countries; in the past there was considerable slack in the capacity to produce output in other countries whenever one country was in a boom period. (In other words, the timing of business cycles was not coincidental in the early postwar period, but in the last decade business cycles have become more synchronized.),
- the breakdown of the Bretton Woods system and the temporary abandonment of the fixed exchange rate system.

The interrelationships between inflation and exchange flexibility were discussed by H. Johannes Witteveen, the Managing Director of the Fund, in the March issue of *Finance and Development*. Although dealing mainly with developed countries, his views are also relevant to some developing countries.

A major policy issue before planners in developing countries is how to take policy measures to reduce the impact of world-wide inflation, or alternatively how to learn to live with a changed world situation. First, before a developing country

can take offsetting measures, it should ensure that domestic pressures are not adding to domestic or world-wide inflation. Otherwise it will be pointless to take measures to fight international inflation while letting domestic inflation go unchecked. Second, it must have the financial strength to resist the effect of world-wide inflation which many developing countries do not possess. The ability to counteract imported inflation is lower in developing countries than in industrial countries.

In brief, the policymaker has to decide how to insulate the domestic economy from the effects of inflation abroad. If the prices of exports rise at least as fast as import prices and foreign exchange reserves are adequate or rising, then an appreciation of the exchange rate would tend to keep domestic prices in local currency unchanged. Since all export prices and all import prices do not move in step, some adjustment problems may have to be faced, such as a slowing down of the growth rate (especially if prices of imported capital goods rise faster than imported consumer goods), or a loss of foreign exchange reserves, or a combination of both.

It is not possible for any economy to insulate itself completely. Therefore, domestic incomes policy, especially the determination of wage rates in different sectors, that is, export versus home market, changing the relative size of government and private sector, and the relative shares of fixed income versus business profits, and so on, will have to be reviewed and adapted.

### Floating exchange rates

The Bretton Woods system of fixed exchange rates based on an international dollar-gold exchange standard received a considerable setback in August 1971 when the United States suspended the convertibility of the dollar into gold, and the *de jure* or *de facto* floating of more and more key currencies since that date. Therefore, in recent years most developing countries have had to make a choice from among complete floating, pegging, or maintaining the value of their currencies in relation to one key currency while allowing the value in relation to other key currencies to vary. This has been in marked contrast to the situation under the Bretton Woods system when a developing country could be assured that linking the value of its currency to one key currency automatically maintained its relation with respect to other key currencies as well.

For some countries in the French franc area (mainly in Africa) and the dollar currency area mainly in Latin America), the choice has been made with little hesitation because of important trading and financial relations with the dominant key currency country. But even for them, there have been adjustment problems not only for some transactions in the balance of payments, such as travel and minor exports, but also for long range policies aimed at diversifying international trade. For other developing countries in Africa (for example, the Malagasy Republic, Nigeria, and Zambia) and in Asia (for example, Sri Lanka and India) which had become integrated with many currency areas and where trade and financial relationships were not dominated by any one country, neither the choice nor the adjustment problems have been easy. In the three East African countries of Kenya, Tanzania, and Uganda, which belong to a common customs area and share certain intergovernmental services, such as transport, the choice has been further complicated by differences of opinion as to what key currency their currencies should be pegged to.

It is for these reasons that in the recent discussions on international monetary reform, the developing countries generally have been very strongly in favor of restoring the par value system as it operated before August 1971. In the envisaged new system the exchange rate mechanism will remain based on stable but adjustable values, but there is provision for countries to adopt floating rates in particular situations, subject to Fund authorization, surveillance, and review. ("Outline of Reform, June 14, 1974" in *International Monetary Reform Documents of the Committee of Twenty*). Meanwhile, the Executive Board of the Fund on June 13, 1974 adopted a decision on guidelines for countries with floating exchange rates. The Fund Executive Board decision is too recent to fully assess how it will operate. The important economic policy question, however, is what key currency a developing country should be linked to. This in part depends on whether the key currency itself is floating or fixed in relation to other key currencies.

This policy question can be decided in part by comparing the net benefits to be gained from linking to alternative key currencies. Although noneconomic considerations will play a role, the following economic considerations should be taken into account: the prospects of the provision of a stable and expanding market

for the exports of the developing country by the key currency country; the prospects of foreign capital, both private and official, flowing in to finance temporary balance of payments deficits and to provide additional resources for financing economic development; the relative financial strength of the key currency in relation to other currencies, especially whether it is more inflation-prone than that of other industrial countries. This point is particularly important in view of the present phenomenon of world-wide inflation, and the efforts of most developing countries to resist the importation of inflation.

One could add to the list of considerations by including the amount of debt owed to the various key currency countries, the stock of foreign investments in the developing countries, and so on. But all these points can be included in the category of relative financial strength of the developing country and the key currency country. It is natural for a country to wish its currency to be linked to the strongest currency, but if its currency is likely to lag greatly behind, then the developing country will suffer from an overvalued currency. On the other hand, if its currency is linked to too weak a key currency, then it is apt to find that its foreign assets in terms of other key currencies will rapidly diminish in value. Therefore, a policymaker can choose a key currency only slightly stronger, relatively speaking, in the balance of payments field. It may also be possible to link with a very strong key currency but not follow suit, either in whole or in part, whenever the key currency is revalued. Similarly, a country could link with a less strong key currency and not follow suit, either in whole or in part, whenever the key currency is devalued. But these alternative approaches will not, of course, provide the advantage of at least a bilateral "par value-fixed exchange rate system" in a floating world.

### Specialization needed

The developing countries' preoccupation with growth, as well as the structural differences between them and the developed countries, will justify specialization in techniques of economic analysis. This can be achieved by exercising care in applying the basic principles of economics and models to developing countries, because, in a one-world economy, the interests of developing countries may not always coincide with the interests of developed countries, at least in the short run.

## Procurement under World Bank projects

*Continued from page 11*

Second, these views ignore the indirect consequences of the award. The prime contractor may well purchase goods and services in other countries; this was the case in the Kariba project, for example.

Further, experience suggests that often suppliers who raise the "fair share" argument are either not competing effectively or not competing at all for Bank-financed business. There may be a variety of reasons for this, such as lack of experience in the developing country where the project is located, inadequate local representation, understandings with other suppliers with respect to the allocation of foreign

markets, overvaluation of the supplier's currency, or full order books and a profitable home market.

Until the creation of IDA, the Bank was able largely to ignore the "fair share" argument. Its capital was already subscribed, and its source of additional funds (the private capital markets of the developed countries) shared its view that ICB was generally the most economical and efficient way of carrying out procurement. The private capital markets therefore regarded ICB as a safeguard protecting the funds they made available to the Bank. But with the creation of IDA in 1960 and the necessity of returning periodically to the governments of the donor countries and their legislatures for replenishment of IDA funds, the Bank had to recognize that the "fair

share" argument could be a political obstacle to replenishment of IDA at adequate levels. It continues, however, to reject the argument as contrary to the letter and the spirit of its Articles and to its objectives as an international, development institution, while it seeks to convince others that ICB is in the best interest of all Bank members over the longer term.

Procurement under Bank loans is an important activity both for the borrower and for other member countries of the Bank, and one which is complex and sensitive because it requires the reconciliation of conflicting interests. The Bank's policy and practice in this field has evolved along lines that are consistent with the Bank's role as an international development institution. **ED**

## New tools for measuring government

*Continued from page 18*

other data systems. How do other data systems view these principles?

Government budgetary accounts have a coverage defined on legal or institutional grounds rather than on the basis of function. As a result, the elimination of enterprise or financial institutions functions may be necessary for the preparation of government finance statistics, as well as the addition of any government functions performed outside the budgetary accounts. In regard to the second principle, budgetary accounts frequently include transactions between government agencies, and sometimes also transactions taking place in other time periods, so that this too may require adjustment for statistical purposes. In the classification of transactions, finally, budgetary accounts are usually guided in part by certain legal criteria, such as transacting entity or account, item purchased, or program involved, and these may or may not readily relate to classification by the nature of the transaction itself.

While government finance statistics are usually derived from government budgetary accounts, these statistics in turn provide many of the data from which the national income accounts are constructed. In general, a close correspondence is found between government finance statistics and national accounts. Both define government, like other institutional sectors of the economy, on the basis of the functions it performs, although government finance statistics exclude from government several financial institution func-

tions performed by it which the national accounts retain in government. Because the national accounts focus on preparation of integrated statistics for all sectors of the economy, they organize data for government in the same way as for other sectors. Government data are organized differently in government finance statistics, however, to reflect the unique character of governmental operations. With regard to the second principle, because the national accounts are concerned with the measurement of production on a basis common to all sectors, they do not seek to measure only actual payments between government and the rest of the economy during a given time period but also deliveries, flows within government, and estimated past and future flows connected with production during a given period. Some difference may also arise with respect to the classification of transactions whose immediate nature or characteristics, utilized by government finance statistics, differ from their eventual use or presumed effect utilized by the national accounts.

A rather close correspondence with the three principles will also be found for the monetary accounts. There is similarity with government finance statistics in the definition of government, the measurement of payments during a given period of time, and classification by the nature of the transaction. Discrepancies may be encountered in valuation, however, since monetary account statistics are drawn up on the basis of changes in stocks between two dates while government finance statistics are generally based on the flow during the period.

With respect to balance of payments

accounts, no difference is encountered in the definition of government by function. Some differences may arise concerning the measurement of payments in government finance statistics, however, as the balance of payments also registers claims and liabilities that may arise in the absence of a generating payments transaction.

It is these ideas that experts from the various countries have before them as they consider the *Draft Manual* at the regional seminars and examine their statistics on government operations for compilation of the Fund's questionnaire. The conclusion of the deliberations, it is hoped, will result in an agreed and fully articulated guide for the compilation of comparable and consistent government finance statistics to meet the needs of each country's analysts and decision makers, as well as the needs of the World Bank and the Fund. **ED**

### Arabic edition

With this issue **Finance & Development** will also be available in an Arabic edition. Readers who wish to receive the Arabic language edition should send their current address label and include their address in Arabic. New readers may also send their requests to:

The Editor  
**Finance & Development**  
(Arabic edition)  
International Monetary Fund Building  
Washington, D.C. 20431





## Book notices

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### A crisis of plenty

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Odell, Peter R., *Oil and World Power: Background to the Oil Crisis*, Baltimore, Maryland, U.S.A., Penguin Books Inc., 1974, ix + 245 pp., \$2.50; Fisher, John C., *Energy Crises in Perspective*, New York, N.Y., U.S.A., John Wiley & Sons, 1974, ix + 196 pp., \$9.95.

Both these books are timely and important. Peter Odell's study of the international oil industry, now in its third edition, contains several amendments to the earlier texts, and an entirely new chapter on "The World of Oil Power." John Fisher's book, though sponsored by the General Electric Company, attempts to provide an "objective" account of the world energy situation. The perspective that Mr. Fisher gives to the current oil crisis is twofold, since he provides a useful, scientific summary of long-term trends in the demand and supply of energy for industry and commerce, as well as a review of energy substitutes for oil.

Professor Odell begins by explaining the shifting relationships among the U.S. government, the U.S. oil interests, the American consumers, and the Middle Eastern suppliers. He points out that the U.S. official policy toward Middle Eastern oil up to 1967 was essentially an intensification of U.S. policy between the world wars and immediately afterward; it was directed at "carving out" commercial oil interests for the United States in an area previously dominated politically by Britain and France. Collective defense agreements and diplomatic pressures were used to keep the Soviet Union's influence either low or negligible in the area. This policy was threatened by rising nationalistic resistance to U.S. dominance, and to treaties which gave effective sovereignty to some of the oil companies. These oil companies had initially obtained the right to control the flow of oil in return for payment of a small royalty.

In addition to gaining an increasing control of Middle Eastern oil through its companies, the U.S. Government did not neglect the systematic protection of its domestic oil producers' interests. Mandatory quotas on the import of oil and oil products were introduced in 1957 by President Eisenhower. Domestic oil producers were thereby guaranteed almost 90 per cent of the existing home market. At that time oil could be landed on the U.S. east coast at a price of \$1.50 a barrel (the cost of production was then less than 10 cents a barrel in the Middle East). The wellhead price necessary to induce the companies to produce some 500 million tons of crude oil a year was thought to be about \$3.00.

World oil markets were weakened as a result of the U.S. quota system. Market prices tended to fall, as increased supplies were unloaded there. The Organization of Petroleum Exporting Countries (OPEC) emerged to meet this situation. One factor that precipitated this development was indeed the action of the multinational oil companies (five of the big seven with headquarters within the United States) in 1959 which sought to reduce their tax and royalty commitments to the oil producing countries, by reducing posted (i.e., selling) oil prices. Venezuela convinced the other main oil producing countries that a cartel would be feasible and successful. For political reasons, such as the need for stability in South America and the Caribbean, the United States government supported Venezuela. Therefore, the OPEC's collaboration with the oil companies in raising world oil prices had, according to Odell, the "positive encouragement" of the United States.

Fisher asks the reader to imagine first, the economic effect on the U.S. energy situation of the discovery of a new oil field able to produce low-cost fuel oil equal to about 1 per cent of U.S. production; second, what would happen if this 1 per cent was in fact 20 per cent? Third, what would the result be if the potential flow was ten times the production of oil in the United States? The third case might lead to disaster for existing U.S. producers. It would also provide a headache for the producers of the new field, because prices might fall to levels that would reduce total net returns and even make economic development difficult. But, in point of fact, a new field of the third type was discovered in the Middle East and this has had a tremendous impact on the economy of world energy.

These two books reflect the view that the energy crisis is a crisis of plenty and not of scarcity. A rise in environmental standards provides good reasons for conserving energy and curbing its wasteful and socially harmful uses, and for legislating against oil spills at sea. But the energy crisis has nothing to do with environmental matters as such, or with the prospect of world resources becoming totally

depleted or more expensive. Oil, even in the known and proven fields, is easy to produce in huge quantities at the cost of a few cents for each barrel. The crisis arises, on this view, when consuming countries dare not let it stay so cheap for political reasons, and producing countries want to maximize their returns from selling their products for both economic and political reasons.

Ian Bowen

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### Mixed honors

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Mitra, Ashok (editor), *Economic Theory and Planning: Essays in Honour of A.K. Das Gupta*, Calcutta, Oxford University Press, 1974, xvi + 325 pp., Rs. 50.

Professor A.K. Das Gupta, one of the distinguished Indian economists, had a checkered career, starting with a professorship at Dacca University in what is now known as Bangladesh, to a senior position in the Asian Department of the International Monetary Fund, and thence to a leading research institute in India. Although his earlier contributions were in the field of economic theory, mainly consumer surplus, he was at equal ease in the area of economic policy. His towering contribution, however, was to help create a generation of first-class economic theorists in India, some of whom have made a major contribution to and have occupied professorial positions at leading universities in the United Kingdom and the United States. For this, if not for anything else, Professor Das Gupta deserves the gratitude of Indians in particular, and the economic profession in general. This volume is a fitting honor to him as a man, as well as an economist.

Although some of the luminaries in the field of economics figure among the contributors, perhaps the most delectable piece in the volume is by Professor A.K. Sen of the London School of Economics. It is on recent controversies in capital theory and is written in the form of a dialogue between Lord Buddha and his disciple, Subhuthi. This piece encapsulates almost all that needs to be said in the realm of capital theory in a witty, yet deep manner. An article by Professor John Hicks on preference and wealth is a restatement of much of his earlier work published in *Revision of Demand Theory and Other Essays*. Professor J.E. Meade's piece on preference ordering and economic policy is also a repetition of earlier works.

There are two essays on equilibrium economics by Mrs. Joan Robinson and Dr. V.V. Bhatt which come by way of a "fall out" from Kornai's classic work *Anti-equilibrium*.

In other essays by Louis Lefebvre, Nurul Islam, and Ashok Rudra the disenchantment of the economist with the type of planning experiments now in vogue in the less developed

countries is clearly brought out. An article on monetary management and nationalization of banking in India by Professor Raj is a somewhat revised version of his earlier lectures.

Dr. Ashok Mitra's preface is beautifully written and presents an excellent profile of Professor Das Gupta. This volume can be easily considered to be one of the best *Festschriften* brought out in recent years.

Deena R. Khatkhate

## European money melange

Readman, Peter, Jonathan Davies, Michael Hoare, David Poole, **The European Money Puzzle**, Michael Joseph, London, International Publications Service, New York, 1973, 165 pp., \$12.50; Denton, Geoffrey (editor), **Economic and Monetary Union in Europe**, Halsted Press, New York and Toronto, 1974, 118 pp. \$14.95.

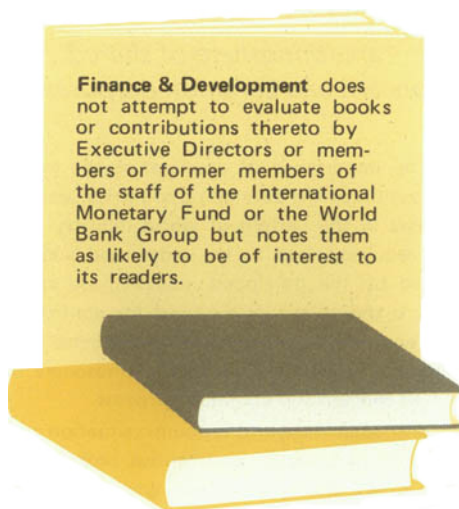
Compared with the impressive dreams of the early visionaries of European unity, the concrete achievements of the European Economic Community (EEC) in the field of monetary unity have been few. Over the years more emphasis has been given to the more concrete and, seemingly, more attainable goals of economic coordination in the fields of the elimination of tariff barriers and agricultural policy than has been given to the intimidating and complex problems of monetary union. Indeed, the basic questions raised by the concept of monetary union remain unanswered. Should the member countries of the Community adopt a supranational attitude and work toward a complete monetary integration with a single currency or unit of account? Or should the Community remain a loose federation of national states, each with its own currency and banking and monetary systems?

Both these books support the general concept of increased European monetary unity, while tackling it from different approaches. The authors of **The European-Money Puzzle** are firm advocates of the principle that the member

countries of the Community should adopt a supranational outlook. However, they give a salutary warning of the entrenched obstacles in the way of greater unification by way of comprehensive descriptions of the workings of the different national financial systems. The authors maintain that there are considerable differences between the various financial markets on the continent of Europe. These are in turn eclipsed by the striking difference between the rigidity and bank orientation of the continental markets and the free markets which control much of the flow of savings to investment in the City of London.

Geoffrey Denton's **Economic and Monetary Union in Europe** results from the work of a Federal Trust Study Group examination of the economic implications of plans to establish an EEC monetary union. The contributors to the study examine particular sectors of the economies of the member countries of the EEC, including labor market policy, regional problems, the capital markets, fiscal issues, and the development of a European Community budget. The study emphasizes that monetary union has self-evident long-term benefits but that it will impose considerable strains on the various sectors of national economies in the short term.

Ian S. McDonald



Sassoon, David M., **C.I.F. and F.O.B. Contracts** (Second Edition), London, England, Stevens, 1975, xxxvii + 472 pp., £15.50.

The first edition of this book in 1968 was a comprehensive and detailed guide to the law and practice of these two important types of international sales contracts. Since 1968 world trade has expanded rapidly and c.i.f. and f.o.b. contracts in various jurisdictions have developed in response. This second edition includes, therefore, an analysis of over sixty new decisions from various countries, and takes full account of appropriate legislation: the Uniform Laws on International Sales Act, 1967, and the Supply of Goods (Implied Terms) Act 1973.

The last few years have also witnessed considerable technological changes. These include the increasing transport of freight by air, and perhaps even more important, the container revolution and the development of the combined transport concept. All these have begun to exert influence on traditional patterns of trade and on the customary trade terms — in fact on the accepted rules which have governed c.i.f. and f.o.b. law for so long. These developments are considered by the author, and account is taken of the efforts of the International Chamber of Commerce to prepare definitions of new forms of c.i.f. and f.o.b. for use in contracts involving these modern modes of transport, although these terms are, of course, not complete.

### Other books received

Johnson, H.G., and A.R. Nobay (editors), **Issues in Monetary Economics: Proceedings of the 1972 Money Study Group Conference** New York, N.Y., U.S.A., Oxford University Press, 1974, viii + 595 pp., \$25.75.

Sellekaerts, Willy, (editor), **Economic Development and Planning; Essays in Honour of Jan Tinbergen**, White Plains, N.Y., U.S.A., International Arts and Sciences Press, 1974, xxiv + 266 pp., \$20.



## Seeking new perspectives

Secretary-General Kurt Waldheim of the United Nations spoke at the opening of the Second General Conference of the United Nations Industrial Development Organization (UNIDO), at Lima, Peru, on March 12, 1975. Here are excerpts from his address:

This year, in addition to the present meeting, we shall have the International Women's Conference, and also the seventh special session of the General Assembly which will be devoted to development and international economic cooperation. This special session is, of course, the logical successor to the special session held

last year and will be of even greater importance to the future economic well-being and political stability of the world, in addition to its effect on the future structure of the United Nations. All these developments will be of crucial importance to the future effectiveness and reputation of the entire United Nations system.

Next year, 1976, the United Nations will convene two other major world conferences on trade and development (UNCTAD IV) and on human settlements.

While each of these meetings is concerned with different aspects of the economic and social problems which confront mankind, they must be regarded as forming the component parts of a new global perspective, and of a new

global strategy to deal with subjects which are truly global in character.

Furthermore, these problems are all inter-related, and they all affect each other in complex ways. Some of them have become so acute that the world community must face them on an immediate and urgent basis if we are to entertain any hope of overcoming them.

The very real danger of starvation confronts many millions of people, and the possibility threatens many millions more. Inflation has become a world-wide phenomenon affecting most countries, and is now combined in some areas with recession and increased unemployment. The fragility and, in some fields, the inequities of the international economic order have put the entire system of international trade and payments under severe strains. Such a combination of circumstances threatens economic and social stability in many parts of the world and in itself constitutes a new threat to peace.

There is now a much greater awareness of the fact that the global problems which confront us can no longer be resolved through national, or even regional, approaches alone. While the nation state is, at this stage in the world's history, the principal executive authority, the nature of these problems requires the development of new international strategies which effectively fulfill the objective of the Charter to make the United Nations "a centre for harmonizing the actions of nations." One of the most encouraging aspects of 1974 was that the need for such an international approach was accepted far more widely than ever before. Now, however, it is essential that we should move into the realm of effective joint action — and do so quickly.

It is evident that industry is a vitally important part of the complex system of international economic relations, and cannot be separated from the other elements. The sixth special session of the General Assembly last April recognized this in the Programme of Action which it adopted, and emphasized the fact that in any new world economic structure there must be a substantially higher participation of the developing countries in world industrial activity.

Industrial output in some developing countries has increased rapidly in the last 25 years, but their total share of world industrial output has remained at the ominously low level of 7 per cent for the last two decades. The participation of these nations in world trade in manufactured goods, although increasing, is still exceedingly small. This situation is understandably viewed with the greatest concern by the developing countries, and in the regional meetings which preceded this Conference they have established targets calling for a substantial increase in their participation in world industrial activity. The results of these meetings demand careful attention and discussion.

Industrial output in the developing countries could and should increase much faster than that. During the last 25 years they achieved a fivefold increase in their industrial output. There is no doubt that they have the potential to achieve even greater progress in the next 25 years. But if they are to do so, much more attention will have to be paid to their industrialization and intensified programs of international industrial cooperation will have to be established immediately to achieve this goal.

All financial institutions, particularly indigenous development banks, will have a crucial role to play in this expansion. But such a process must go hand in hand with the urgently needed expansion of agriculture in the developing countries. The situation varies widely from nation to nation, and from region to region, and each country must therefore carefully examine its development priorities in the light of its own requirements, and the world Organization must assist in devising strategies which effectively reconcile national and regional necessities.

This calls for new perspectives, the courage to admit errors, and the determination to face facts as they are, and not as we would wish them to be. It also calls for new concepts of practical cooperation.

*"an atmosphere of shared concern and common purposes"*

The importance of accelerating the industrialization of the developing countries, and the changes in the pattern of world industry that this requires, need to be understood and accepted by the developed industrialized countries. It should not be a subject for confrontation and conflict, but should be discussed and negotiated on both sides in an atmosphere of shared concern and common purposes.

Although the world economic situation contains many complex and serious problems, it also offers new possibilities which we must seize. Only as we realize the benefits of interdependence will we discover new opportunities for creating more equitable economic relations between poor and rich countries.

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## Defining the contours of world economics

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The following are excerpts from a speech by Iranian Prime Minister Amir Abbas Hoveyda at the opening of the Iran-Europe International Economic Symposium on March 15, 1975 in Teheran.

Our world today, more than ever before, faces multiple difficulties. We are grappling at this moment with a series of problems of global

scope; and no country, no matter how powerful or rich, can pretend to confront and triumph over these problems alone. The nature and the quality of the life that future generations will lead on our planet depends more than ever on the ability of all nations, large or small, industrialized or developing, to cooperate with one another and to prepare effectively for the future in the interest of all.

A concern for the future must lie at the core of every important decision. Certainly, the future cannot be foreseen, and many futurologists have met with resounding setbacks. But the future can be invented. It is, moreover, what responsible men and women in every field do and have done — even, perhaps without knowing it, in the manner of M. Jourdain — that matters. The new element is that it is now a question of profiting from our recent discoveries to foresee events, as Daniel Bell has said, to have an advantage over our ancestors.

Obviously, the thoughts which I suggest to you are not intended to provide immediate solutions to problems. It is simply a question, I submit, of examining the concepts, in order to better understand different motivations and opinions and to define the contours of the perspectives and choices which are available.

This may perhaps sound astonishing, but I believe that at heart the present crisis has even a positive aspect: it confronts the industrial states, willy nilly, with problems about which they speak, but whose real import they neither feel nor appreciate.

Over the years, in international forums and elsewhere, we have spoken of these problems. But no one ever heard us. We called for help. But no one gave it to us. Our appeals were scattered by the winds, and our cries of distress raised no echo. It required the petroleum crisis to awaken consciences. Analyses increased. And the results of international conference have at last enlightened the most recalcitrant.

The world crisis has provided evidence for the fact that the development, wealth and power of the industrial states have been founded largely on the underdevelopment, the poverty and the weakness of two thirds of humanity. However, these lessons have not yet been assimilated. A minority still seeks to determine the destiny of the world by refusing to share resources, means and responsibilities.

We have thus recently heard voices seeking to blame the existing economic disorder on the increase in the price of petroleum. They have spoken of the artificial, exorbitant, excessive and unreasonable rise in prices. According to their Cassandras, if these prices are not immediately lowered, the world will move toward disaster. We have heard talk of occupation, of seizure of the oilfields, of the cut-off of food exports to the oil producing states and I don't know what else.

Such threats may impress the unknowledgeable. But they cannot convince serious and informed observers.



Considering that Iran is among the principal producers of oil, I must make some comments on this matter.

It is often said that the lamentable state of the world economy as well as inflation are the result of the readjustment of the price of petroleum. In fact, the rate of inflation began its upward spiral and reached astronomic proportions more than five years ago, thus eroding the purchasing power of the oil producing states.

*"a new economic order based on equity, sovereign equality, interdependence, common interests and cooperation among all states"*

Each year, the producers of primary materials had to pay the equivalent of a larger volume of their products to secure an equal volume, if not a smaller amount, of imports of food products, machinery and manufactured goods. This was a process which led, as we have said and repeated often in the past, to a systematic impoverishment of the developing states, while the developed industrial states grew increasingly wealthier.

At the same time, and in spite of allegations to the contrary, the increase in petroleum prices has had only a small impact on inflation. In fact, according to statistics produced by the experts of the industrialized states themselves, imported petroleum contributed only 0.45 per cent to the rate of inflation of the United States and about 1.5 per cent to the rate of inflation of other countries, while the general rise in prices in all these countries exceeded an average of 12 per cent.

In other words, the disorder in the world economy and in international money markets preceded the rise in petroleum prices and was essentially due to the poor management of the economy in America and the European states, and also to excessive consumption in the most advanced countries.

The increase in petroleum consumption at low prices, combined with the decrease in oil prices in the industrialized countries, constituted a major contribution to widening the gap between the poor and the rich countries. Thus the developed states progressed rapidly at the expense of the oil producing countries.

These countries, growing rich at our expense, paid no attention to the problems of the developing countries. They did not even consent to allocate 1 per cent of their gross national product for the development of the under developed states.

We, on the contrary, have always taken the problems of the developing countries into consideration. Since the readjustment in the price of oil became a reality, we have begun to furnish bilateral and multilateral aid to the

developing as well as the developed countries, assistance to which I shall return. We are equally conscious of the need for recycling. But this cannot and will not come about except through a reasoned exchange of views and multilateral discussions. The accusations directed at the producing countries will solve nothing.

The persistent economic disequilibrium in the relations between the developed and the developing countries, however, is grave, and the process which continues to widen the gap between them so inexorable, that action can no longer, as in the past, be limited to simple corrective interventions or ad hoc measures. If we wish to succeed, we must undertake a concerted effort to launch a fundamental revision of the concepts and practices underpinning the international economic system.

Real structural changes will be achieved if we are prepared to elaborate a new economic order based on equity, sovereign equality, interdependence, common interests and cooperation among all states. In this context, it is to be hoped that the world's industrialized countries will not lose the opportunities which are now available for cooperation with others in the search for appropriate solutions.

For its own part, Iran remains fully conscious of the necessity to assist other countries, particularly the developing states, without forgetting the industrialized countries needing assistance. I will not here attempt to give you a detailed picture of my Government's efforts in this field. But it is perhaps useful to recall that the total sum of Iran's bilateral and multilateral undertakings toward other countries has already reached a figure of \$10 billion.

## A nobel view

**Gunnar Myrdal spoke about the emerging trends on the world economic scene in his lecture delivered in Stockholm on March 17, 1975 when he received the Alfred Nobel Memorial Prize in Economic Sciences. Here are excerpts from his lecture:**

In recent years there have been sudden major changes in the world economy. They have radically affected the economic situation of all underdeveloped countries, though in different directions and degrees, and thereby the entire setting of the equality problem (among nations). For by far the larger part of the peoples in underdeveloped countries, these changes have been worsening their development prospects and in many countries are now threatening the survival of large numbers of their poor masses. The type of marginal foreign aid we have provided is clearly not enough to meet their barest needs.

The underdeveloped countries are therefore now proclaiming the necessity of not only increased aid but fundamental changes of inter-

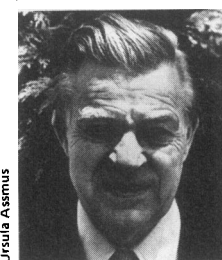
national economic relations. By their majority votes they can in the United Nations carry resolutions like the "Declaration on the Establishment of a New International Economic Order," passed at the conclusion of the Special Session of the United Nations General Assembly held in April 1974 to consider the emergency situation.

Particularly delegates from the group of smaller countries, that had already in the earlier epoch consistently shown more sympathy for the cravings of underdeveloped countries and who have also maintained or even increased their modest aid, have often voted for the most general though noncommittal declarations.

And they have sometimes positively expressed agreement with the radical demands for a new world order, which logically must imply an infringement of their countries' share of the world's resources. They must then have spoken and voted without much sincerity, as they cannot have been ignorant about the fact that the nations they represent are not really prepared to give up privileges, least of all on a scale commensurate with their general promises.

As development is frustrated and living level brought downward among the masses because of the oil crisis and the food crisis, any population policy, which might be inaugurated, becomes less effective. And so the food crisis becomes goaded in the way of circular causation with cumulative effects.

In this situation there are certainly moral and rational reasons for a new world order and to begin with, for aid on a strikingly much higher level. In particular, people in the rich countries should be challenged to bring down their lavish food consumption. It is estimated that if the average American were to reduce his consumption of beef, pork and poultry by 10 per cent, 12 million tons or more of grains



Ursula Asmus

would be saved. This would mean making so much more food aid possible, saving perhaps five times as many million people as tons released, or even more, from starvation in the poorest countries.

As has also been amply demonstrated, the cutting down of consumption, and of production for home consumption, of many other items besides food, and in all the developed countries, is rational and in our own interest. This is what the discussion of the "quality of life" is all about. Our economic growth in a true sense could certainly be continued, but it should be directed differently, and in a planned way, to serve our real interest in a better life. At the same time, it would release resources for aiding the underdeveloped countries on a much larger scale and to begin with for solving the acute food crisis.

Real economic planning should be done in

these rational terms. Such planning could help us to be more successful in solving the internal equality problems and would at the same time provide for a much larger aid to development in underdeveloped countries. In the first place, it could prevent the serious risk of human dis-

asters for the majority of the poorest peoples in these countries. The blunt truth is that, without rather radical changes in the consumption patterns in the rich countries, any pious talk about a new world economic order is humbug.

According to present estimates as many as

10 million people may starve to death this year, and at least half a billion are hovering on the brink of starvation. It is against the background of the expectancy of world catastrophes that the attitude in developed countries has to be considered in moral terms.



### World map

Editor,

When coloring the world map on the cover pages of the March 1975 issue of **Finance & Development** the man with the brush seems to have been carried away a bit. With astonishment I noticed that (on the back page) Papua New Guinea, the British Solomon Islands Protectorate, Fiji and Western Samoa (all of them north-northeast of Australia) are colored as developed countries. However, all of these countries have per capita incomes not exceeding US\$500 equivalent.

On the front page, I was surprised to find Spain to be shown as a developing country while Portugal, evidently with a notably lower per capita income than Spain was colored as a developed country.

Guenter H. Reif  
World Bank  
Washington, D.C.

Editor,

Please allow me to draw your attention to the front cover of the current edition of **Finance & Development** (vol. 12, no. 1, March 1975).

In reference to the front cover map, Cuba has been placed in the category "developing countries." On the other hand, the 1974 edition of *World Bank Atlas* classifies Cuba under the category "centrally planned economies" (see map on p. 8). Since "centrally planned economies," as distinct from "developed countries" and "developing countries," encompasses both developed and developing countries, the fact that Cuba is a developing country cannot preclude its inclusion.

Sang E. Lee  
World Bank  
Washington, D. C.

*Editor's note:*

*In our map we followed in general the categories used in "World Economic Indica-*

*tors," prepared in the World Bank. Under those categories Cuba is listed as a "centrally planned economy," so our coloring was not consistent, and the error is regretted.*

*Any broad categorization is, however, inevitably going to result in some anomalies, arising from changing political boundaries that enclose varying economic regions and dependencies.*

*The three categories "developed," "developing," and "centrally planned" are themselves of course incommensurate with each other. On an income per capita basis, some centrally planned economies are no doubt "developed."*

*Our reason for classifying Portugal as developed was explained in a footnote.*

### Ecuador's point

Editor,

In the March 1975 issue of your quarterly publication, there is an article by Mr. Bension Varon, Senior Economist in the Policy Planning Division of the Policy Planning and Program Review Department of the International Bank for Reconstruction and Development, dealing with the problems of the Law of the Sea.

In that article, reference is made by the author to the 200-mile limit issue, in which he makes the following statement: "... Chile, México, Nicaragua, and Peru, by the same date, were claiming rights up to 200 miles away. . . ." As in my view, apart from excluding Ecuador and other countries - like Brazil, Uruguay, El Salvador which have also adopted the 200-mile territorial sea principle - the article does not reflect the true state of affairs, I would like to call your attention and that of the author to the following aspects:

The so called Santiago Declaration, signed by Ecuador, Chile and Peru, on August 18, 1952, established the exclusive rights and full sovereignty of those three countries to the stretch of 200 miles of the sea off their coasts, including the soil and subsoil, and in accordance with the geographical, biological, ecological, social and other factors relevant to each country.

As is well known, more than 13 countries have so far adopted the full sovereignty principle over the 200-miles of their territorial sea.

Also known is the fact that Ecuador has been exercising full sovereignty over its 200-mile

territorial sea, and enforcing its rights against any violation by foreign vessels fishing within that area without the corresponding registration and fishing licenses granted by the proper Ecuadorean authorities.

José C. Cárdenas  
Ambassador  
Embassy of Ecuador  
Washington, D.C.

Mr. Varon replies:

*"I am grateful to the Ambassador for raising this issue. However, the countries named in the article were mentioned only for illustrative purposes. There was no intention to comment on the legal state of affairs by excluding Ecuador or any other country."*

### Extra copies

Editor,

I read with great interest Mr. Premchand's article, "Budgetary Reforms in Developing Countries," in the March issue of **Finance & Development**. I represent a project of the Division of Science and Technology Policies of UNESCO directed to development of techniques for special analysis of government expenditures on science and technology related to development objectives—an undertaking which seems in keeping with your recommendations for "immediate tasks."

I would like very much to obtain 20 copies of this article for distribution to those connected with this project.

Gordon R. Chapman  
Chapman Research Associates  
4136 Leland Street  
Chevy Chase, Maryland 20015

*The extra copies requested by you have been sent. We are always willing to supply a reasonable amount of extra copies for such projects.*

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