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A PROPOSAL TO LINK RESERVE CREATION AND DEVELOPMENT ASSISTANCE

REPORT

OF THE

SUBCOMMITTEE ON INTERNATIONAL EXCHANGE AND PAYMENTS

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

AUGUST 1969

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LETTERS OF TRANSMITTAL

AUGUST 15, 1969.

To the Members of the Joint Economic Committee:

Transmitted herewith for the use of the members of the Joint Economic Committee and other Members of Congress is a report of the Subcommittee on International Exchange and Payments entitled "A Proposal to Link Reserve Creation and Development Assistance."

The views expressed in this subcommittee report do not necessarily represent the views of other members of the committee who have not participated in hearings of the subcommittee or in the drafting of this report.

Sincerely,

WRIGHT PATMAN,
Chairman, Joint Economic Committee.

AUGUST 14, 1969.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
Congress of the United States, Washington, D.C.

DEAR MR. CHAIRMAN: Transmitted herewith is a report of the Subcommittee on International Exchange and Payments entitled "A Proposal to Link Reserve Creation and Development Assistance." This report has been approved by a majority of the members of the subcommittee.

The subcommittee wishes to express its gratitude and appreciation for the guidance it has received from the experts who appeared before it as witnesses.

Sincerely,

HENRY S. REUSS,
Chairman, Subcommittee on International Exchange and Payments.

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A PROPOSAL TO LINK RESERVE CREATION AND DEVELOPMENT ASSISTANCE [1]

1. The Special Drawing Rights Amendment Has Been Ratified

The Special Drawing Rights (SDR) amendment to the Articles of Agreement of the International Monetary Fund (IMF), having secured the approval of the required number of Fund members, was ratified on July 28, 1969. Acceptance by national legislatures created the SDR facility but failed to insure its use. To activate the amendment, members holding 75 percent of the total voting power had to indicate their willingness to participate; this requirement was met on August 6, 1969. But an 85 percent majority must still be obtained in favor of a specific proposal to distribute a given amount of SDR's over a stated period. The major industrial nations have apparently agreed to create $3.5 billion worth of SDR's during the first year the facility is in use and $3 billion during each of the two succeeding years. Thus, total distributions of SDR's will amount to $9.5 billion over the initial three-year basic period. It is expected that formal agreement to activate the facility will be reached at the Fund's next annual meeting in Washington during September.

Once a decision has been made on the total amount to be distributed, the stated quantity will be allocated among individual Fund members. A member voting against the size of a particular suggested distribution, because the proposal is believed to be excessive or deficient, may nevertheless elect to participate in a subsequent allocation.

Members will be required to accept SDR's from other participants up to a limit equivalent to three times their past allocations from the Fund. Thus, if a country received $100 million worth of SDR's from the IMF, it would be obliged to accept as much as an additional $200 million from other members. In return for SDR's accepted from other Fund members, a nation must supply its own currency. If a participant elects to withdraw from the IMF Special Drawing Account, the Fund is obliged to redeem any Special Drawing Rights held by the withdrawing member with gold or convertible currencies. In such an event, the Fund would obtain the required currencies or gold from the remaining participants in the Special Drawing Account, according to the strength of their balance-of-payments positions and the size of their reserves.

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[1] Senator Stuart Symington states: "I do not support the proposal advanced in this report."

Representative Richard Bolling states: "Since other responsibilities prevented my participating in the hearings on which this report was based or evaluating the arguments presented therein, I am unable to take a position on this report."

Representatives Widnall and Brock do not endorse this report. Their supplementary views appear on page 15.

The agreement specifies that Special Drawing Rights will not be earned by Fund members, but will be distributed among them in proportion to their respective quotas. The wealthy industrial nations have contributed most to the International Monetary Fund, and consequently their quotas are the largest. The SDR amendment will thus operate to give approximately 64 percent of the new reserves created under it to Japan and the industrial powers of North America and Western Europe.[2] The United States and the United Kingdom will together receive 36 percent.

Special Drawing Rights will be generalized claims that can be used to obtain the currency of any nation participating in SDR allocations. When SDR's are distributed, these assets will bring an increase in the stock of claims that each recipient can spend externally and that foreigners will readily accept. Those countries that are already the richest will enjoy the largest additions to their reserves. While an agreement to create money and then donate most of it to the wealthy seems inequitable, this arrangement for distributing SDR's has a logical basis. The industrial countries are the largest international traders and therefore may be subject to the greatest absolute payments deficits. Moreover, since industrial countries produce most of the world's goods, expenditures of SDR's will presumably be used largely to finance purchases of their products. Thus, under the current agreement, most SDR's will be available to meet the payments deficits of major industrial nations. But as the following discussion explains, Special Drawing Rights need not be relegated to this task alone.

2. The Problem: Inadequate Development Aid

The United Nations designated the 1960's as the decade of development, but the growth of per capita incomes has shown no significant increase over the performance of the 1950's, and in some areas, progress has actually slackened. (See table 1.) In view of the continuing and increasing needs of the developing nations for financial assistance, and considering the failure of the industrialized world to fulfill the commitment undertaken at the New Delhi UNCTAD conference in 1968 to furnish aid for development equivalent to one percent of GNP, the wealthy countries should not be content to use the SDR facility for reserve creation alone. It can also be employed, without compromising its fundamental purpose or impairing its usefulness, to help raise financial transfers to the promised level. However, supplying real development assistance equivalent to one percent of GNP also requires—if goods and services are to be provided while avoiding inflation—fiscal and monetary policies in industrial countries such that consumption and investment are held within bounds sufficient to leave one percent of GNP free for development assistance.

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[2] Countries considered by the IMF to be industrial are Austria, Belgium, Denmark, France, Germany, Italy, The Netherlands, Norway, Sweden, Switzerland (not an IMF member), the United Kingdom, the United States, Canada, and Japan—a total of 14. In addition to these countries, Australia, Finland, Kuwait, Luxembourg, and South Africa have contributed to IDA—a total of 19. Australia and Portugal, plus the 14 industrial countries, constitute the membership of the OECD Development Assistance Committee. The major industrial powers comprising the Group of Ten are Belgium, Canada, France, Germany, Italy, Japan, The Netherlands, Sweden, the United Kingdom, and the United States.

TABLE 1.—REAL GROSS DOMESTIC PRODUCT, POPULATION AND GROSS DOMESTIC PRODUCT PER CAPITA—REGIONAL SUMMARY

[Average Annual Rates of Growth (percent)]

	1050–60	1960–67
Developing countries:		
Gross domestic product	4.6	5.0
Pooulation	2.2	2.5
Gross domestic product per capita	2.3	2.5
Africa:		
Gross domestic product	4.0	4.0
Population	2.3	2.4
Gross domestic product per capita	1.7	1.6
South Asia:		
Gross domestic product	3.6	4.1
Population	1.9	2.4
Gross domestic product per capita	1.7	1.7
East Asia:		
Gross domestic product	4.7	5.6
Population	2.5	2.7
Gross domestic product per capita	2.1	2.8
Southern Europe:		
Gross domestic product	5.2	7.1
Population	1.4	1.4
Gross domestic product per capita	3.7	5.6
Latin America:		
Gross domestic product	5.0	4.5
Population	2.8	2.9
Gross domestic product per capita	2.1	1.6
Middle East:		
Gross domestic product	6.0	7.2
Population	3.0	2.9
Gross domestic product per capita	2.9	4.2
Industrialized countries:		
Gross domestic product	4.0	4.8
Population	1.2	1.2
Gross domestic product per capita	2.8	3.6

Source: World Bank.

Aid from developed to less developed countries approached one percent of GNP during the first years of this decade, but declined thereafter. Net financial transfers from the 16 OECD Development Assistance Committee (DAC) nations amounted to ninety-six one-hundredths of one percent of GNP in 1961, but had dropped to seventy-four one-hundredths by 1967. (See table 2.) The United States has consistently made net financial transfers totaling a smaller proportion of GNP than the United Kingdom, France, Switzerland, Belgium, and The Netherlands. Despite our 1968 pledge, U.S. foreign aid budgets have been slashed. Robert S. McNamara, President of the World Bank, noted in his December 5, 1968, report to the U.N. Economic and Social Council, "The reduction in the development aid effort of the United States, in particular, is so severe as to offset what otherwise would be a rising trend."

To compound this unfortunate situation, development efforts initiated in the poorer countries during earlier years have progressed, and many of these nations are able to absorb and use with greater efficiency larger capital inputs than formerly. But the supply of capital to introduce advanced technology has not increased sufficiently. Faced with the unabated pressure of population increases and with the growing burden of obligations to service previous loans, poor nations will become increasingly frustrated by the failure of the industrialized world to respond.

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TABLE 2.—DEVELOPMENT ASSISTANCE COMMITTEE MEMBERS—NET FLOWS TO LESS-DEVELOPED COUNTRIES OF FINANCIAL RESOURCES [1] AND NET OFFICIAL TRANSFERS,[2] AS A PERCENTAGE OF GNP, 1960–67

[In percent]

	1960	1961	1962	1963	1964	1965	1966	1967
Australia:								
Net official and private flows	0.39	0.43	0.41	0.49	0.54	0.60	0.55	0.68
Net official flows	.30	.43	.41	.49	.48	.53	.51	.63
Net official transfers	(3)	.42	.41	.49	.48	.53	.51	.63
Austria:								
Net official and private flows	.09	.30	.43	.08	.25	.51	.49	.45
Net official flows	(4)	.03	.19	.03	.17	.37	.36	.36
Net official transfers	(3)	.03	.19	.02	.17	.36	.34	.34
Belgium:								
Net official and private flows	1.59	1.35	.91	1.26	1.05	1.30	.97	.78
Net official flows	.88	.76	.54	.57	.46	.60	.44	.51
Net official transfers	(3)	.74	.52	.56	.45	.58	.44	.50
Canada:								
Net official and private flows	.39	.24	.29	.33	.32	.35	.50	.44
Net official flows	.20	.17	.14	.24	.29	.26	.39	.37
Net official transfers	(3)	.16	.14	.24	.28	.24	.38	.36
Denmark:								
Net official and private flows	.64	.50	.20	.13	.35	.15	.22	.21
Net official flows	.09	.12	.10	.12	.12	.13	.23	.23
Net official transfers	(3)	.12	.10	.12	.12	.13	.23	.23
France:								
Net official and private flows	2.19	2.17	1.93	1.55	1.54	1.38	1.30	1.23
Net official flows	1.40	1.46	1.35	1.06	.94	.80	.73	.76
Net official transfers	(3)	1.43	1.32	1.03	.91	.76	.70	.74
Germany, Federal Republic of:								
Net official and private flows	.88	1.03	.73	.64	.68	.64	.61	.94
Net official flows	.49	.76	.53	.46	.41	.42	.40	.45
Net official transfers	(3)	.75	.51	.44	.37	.37	.35	.39
Italy:								
Net official and private flows	.88	.69	.93	.66	.45	.47	1.03	.43
Net official flows	.31	.21	.25	.22	.09	.15	.20	.30
Net official transfers	(3)	.19	.23	.19	.06	.12	.16	.27
Japan:								
Net official and private flows	.58	.73	.49	.40	.37	.57	.68	.73
Net official flows	.26	.21	.15	.21	.15	.29	.29	.34
Net official transfers	(3)	.20	.14	.20	.14	.27	.27	.31
Netherlands:								
Net official and private flows	2.11	1.61	.85	.92	.69	1.25	1.23	1.00
Net official flows	.31	.45	.49	.26	.29	.36	.45	.50
Net official transfers	(3)	.43	.47	.24	.27	.35	.44	.48
Norway:								
Net official and private flows	.23	.55	.13	.38	.36	.55	.23	.36
Net official flows	.22	.18	.13	.36	.27	.17	.17	.19
Net official transfers	(3)	.18	.13	.36	.27	.17	.17	.19
Portugal:								
Net official and private flows	1.46	1.63	1.41	1.65	1.82	.81	.97	1.75
Net official flows	1.46	1.63	1.41	1.65	1.82	.56	.60	1.04
Net official transfers	(3)	1.52	1.28	1.49	1.62	.39	.38	.88
Sweden:								
Net official and private flows	.38	.37	.24	.32	.36	.36	.49	.50
Net official flows	.05	.06	.12	.14	.18	.19	.26	.25
Net official transfers	(3)	.06	.12	.14	.18	.19	.26	.25
Switzerland:								
Net official and private flows	1.82	2.22	1.53	1.76	.87	1.45	.74	.78
Net official flows	.04	.25	.05	.05	.07	.02	.02	.03
Net official transfers	(3)	.24	.04	.05	.07	.02	.01	.02
United Kingdom:								
Net official and private flows	1.23	1.17	.93	.84	.99	1.03	.89	.81
Net official flows	.57	.60	.52	.49	.53	.48	.50	.46
Net official transfers	(3)	.54	.46	.42	.46	.41	.42	.39
United States of America:								
Net official and private flows	.75	.86	.77	.76	.75	.79	.66	.69
Net official flows	.54	.65	.62	.62	.54	.52	.48	.46
Net official transfers	(3)	.63	.59	.59	.50	.50	.45	.43
Total DAC countries:								
Net official and private flows	.89	.96	.82	.77	.75	.80	.73	.74
Net official flows	.54	.63	.57	.54	.48	.47	.45	.46
Net official transfers	.52	.60	.55	.52	.45	.44	.42	.42

[1] Net of amortization, and capital repatriation in the case of private flows.
[2] Net of amortization and interest payments received (official).
[3] Not available.
[4] Nil or negligible.

Sources: OECD, "The Flow of Financial Resources to Less-Developed Countries," 1961–65; "Development Assistance Efforts and Policies, 1968 Review"; United Nations Monthly Bulletin of Statistics, various issues.

The two United Nations agencies with global responsibilities for channeling financial assistance to developing countries are the World Bank (IBRD) and its affiliate, the International Development Association (IDA). To counteract the declining trend in official assistance, World Bank President McNamara voiced in December 1968 his intention "that the World Bank Group during the next five years lend twice as much as in the previous five." Most of the Bank's resources will in the future presumably continue to come from the sale of bonds in the capital markets of the developed countries, as has been the case in the past. Because of the high yields necessarily paid on these bonds, most World Bank funds go to semideveloped nations or to finance projects with a short repayment period. The International Development Association by contrast, does not issue bonds and is dependent upon donations from contributors to continue functioning.

IDA was created in 1960 to lend at concessionary terms to the poorest of the developing nations and to finance investments in people and physical resources that have particularly long repayment periods. A standard IDA loan permits the borrower to repay the principal in convertible currencies over a 50-year span. The borrower is initially granted a 10-year grace period, and is then expected to repay one percent of the principal annually for each of the next 10 years. During the remaining 30 years, three percent of the principal is repaid annually. To cover IDA's administrative costs, an annual service charge is also imposed equivalent to three-fourths of one percent of the loan outstanding.

Former World Bank President George Woods pointed out at the 1967 annual meeting in Rio that "if the volume of development finance does not grow, and if there is no improvement in terms, development aid will simply eat itself up." Data provided in the 1968 annual report of the World Bank and IDA show that debt service payments as a percentage of total public and private loans and grants to developing countries increased from 40 percent in 1965 to nearly 45 percent the following year. Debt service payments as a proportion of loans and grants declined to 39 percent in 1967, primarily as the result of substantial increases in official loans to southern Europe and private loans to Latin America. But without either the continued expansion of total financial assistance to developing nations or a shift toward granting a greater share of aid on concessionary terms, debt service obligations assumed in the past will consume most of the new assistance extended. The growing tendency of debt servicing obligations to absorb newly granted aid, and the need of poor countries for assistance at concessionary terms make it essential that the resources of the International Development Association be expanded.

Present IDA resources have been substantially exhausted; lending in 1968 amounted to only a little more than $100 million; former Bank President Woods in 1966 suggested an IDA replenishment at the annual rate of $1 billion as the minimum required. The actual replenishment rate recently approved is $400 million annually (of which the U.S. share is $160 million) for each of the next 3 years.

3. The Proposal: Linking SDR's and Development Assistance Under IDA

We recommend that at the September 1969 annual meetings in Washington of the International Monetary Fund and the World Bank a resolution along the following general lines be introduced and discussed by the Governors of the two institutions:

Resolved, that the Executive Directors of the International Monetary Fund and the International Bank for Reconstruction and Development promptly consider an amendment to the IMF Articles of Agreement, supplementing the Special Drawing Rights amendment ratified on July 28, 1969, whereby those 18 IMF members who have previously contributed to the International Development Association would direct that 25 percent of their Special Drawing Rights allocations be retained by the IMF to finance expanded IDA development assistance.

If the Executive Directors proceed promptly to draft an amendment, and it is then adopted by the Governors of the two institutions and ratified by the member legislatures, including the United States Congress, we would hope that a link between SDR's and development aid might be established at an early date.

The main issue confronting the Governors would be whether to link SDR's and development aid. But the proposed amendment to the IMF Articles of Agreement would also have to overcome several technical obstacles. Solutions to these problems might include the following modifications of the SDR facility:

(*a*) Permitting the IMF to retain as "treasury stock" 25 percent of the SDR allocations of the 18 wealthy members that have contributed to IDA. The Special Drawing Rights amendment contains no such authority.

(*b*) Allowing the retained SDR's to be cashed at IDA/IMF direction, irrespective of the balance-of-payments and reserve positions of the initial recipients. The present amendment restricts the use of SDR's to countries in weak balance-of-payments and reserve positions.

(*c*) Exempting the withheld 25 percent of allocations from the provisions of the Special Drawing Rights amendment requiring "reconstitution" of 30 percent of SDR allocations. The overall "reconstitution" obligation of the wealthy contributors would be diminished to 22.5 percent—not a very serious reduction when one considers that the original 30 percent figure was largely picked out of the blue.

(*d*) Providing that the acceptance and cancellation provisions of the SDR amendment apply to the wealthy Fund members just as if they had obtained 100 percent of their allocations.

The details of the above proposed resolution are, of course, variable:

The 25 percent withholding level could be increased or decreased.

Instead of the 18 IDA contributors, the nations listed for participation (of course, it would be up to each nation to decide on its own participation) might be the 16 on the Development Assistance Committee of the OECD, the 13 members designated by the IMF as industrial nations, or the Group of Ten. (See footnote, p. 1.)

The financing mechanism could be subject to variations in detail. The mechanism suggested in the above proposed amendment envisages that the IMF would from time to time convert the 25 percent of SDR's that the IMF holds into hard currencies designated by IDA as needed to fund the Association's regular development loans. IDA's obligation to the IMF would be the same ultimate obligation as it owes its other contributors for their initial donations and replenishments.

Finally, the beneficiaries could be enlarged to include not only IDA, but the regional development banks, such as the Inter-American Development Bank, the Asian Development Bank, and the African Development Bank. But the universal character of IDA, plus its recent worldwide lending emphasis, and its closer World Bank affiliation, suggest that it should be the exclusive dispensing agency.

The recommendation to link reserve creation and development assistance represents the evolution of ideas shared by members of this subcommittee for several years. A report by Representatives Henry S. Reuss and Robert F. Ellsworth to the Joint Economic Committee in December 1965, *Off Dead Center: Some Proposals to Strengthen Free World Economic Cooperation*, recommended: "The World Bank should take the initiative in proposing a plan to link new reserve creation with the provision of additional assistance to the less developed countries."

In December 1967, the subcommittee issued a report, *Guidelines for Improving the International Monetary System: Round Two*, which noted that: "The Rio resolution calling for IMF studies of schemes 'for stabilization of prices of primary products' enables the United States, after the agreement has been ratified and activated, to raise the question of channeling part of the new SDR's through the International Development Association for economic development purposes." Thus, our proposal details the mechanics for achieving a goal that we set some time ago.

4. Advantages of the Proposal

The above proposal has the following advantages:

(a) It would double IDA's lending capacity, to approximate the recommended $1 billion annually.

As has been noted above, the present IDA replenishment of $400 million annually is far less than the $1 billion initially requested. Under the agreement apparently reached by the Group of Ten for the first three years of SDR distributions, the global total for the 111 nations of the IMF would average almost $3.2 billion annually. The portion of this sum allocated to the 18 IDA contributors (omitting Switzerland, which is an IDA contributor but not a Fund member) would amount to $2.5 million annually. Twenty-five percent of the contributor allocations would total nearly $540 million annually. The United States would annually forgo an average of $192 million of SDR's from its total allocation of $770 million. Thus, the proposed link would more than double the present IDA lending capacity and bring its total lending capacity close to the recommended figure of $1 billion each year.

The International Development Association might wish also to consider a further suggestion made by Governor David Horowitz of the Central Bank of Israel regarding its regular replenishment funds. Under this proposal, the World Bank family would increase its borrowings in private capital markets; IDA would greatly expand its easy-credit loans, and cover the interest differential with part of its replenishment funds. A similar device, it will be recalled, is contained in the Housing and Urban Development Act of 1968, whereby low income homeowners and renters are given an interest subsidy to cover the difference between a subsidized one percent interest charge and the 7 or 8 percent market rate. Such an interest subsidy would enable IDA to greatly expand its lending power at no additional cost.

(b) It would obviate the balance-of-payments problem which inhibits present aid-giving.

A donor nation's weak external position frequently provides an excuse for curtailing economic development assistance. While this argument is of doubtful validity, because tying can reduce the foreign exchange cost of aid to as little as one-tenth of the gross financial outlay, it has nevertheless been used effectively to cut aid programs in the United States and elsewhere.

The proposed amendment linking SDR's to development assistance would effectively remove the balance-of-payments problem from this sector of aid giving.

First, the donor countries would be cutting themselves off at the source from the indicated 25 percent of their SDR allocations. In this respect, they would be in a position similar to that of a worker in the United States who immobilizes a portion of his anticipated income by participating in the U.S. savings bond payroll-deduction plan. The donor nations would, of course, receive 75 percent of their SDR allocations, and would thus be in a better reserve position than they are now. Decisions on the amount of SDR's to issue each year will be made by considering global reserve needs. This same criterion would be used were the 25-percent linkage provision to be adopted. Thus, it is fair to say that the linkage proposal substantially eliminates the balance-of-payments problem—although, of course, one can always argue that even wealthy countries would always like to get the withheld 25 percent of new reserves without earning them, as well as the 75 percent they will get anyway.

Second, even the 25 percent of withheld SDR's will shortly come back to the group of wealthy donor countries as developing nations spend them to finance imports. Of course, whether each donor gets back its 25 percent contribution depends on its competitive ability to sell the goods the developing countries need.

(c) It would obviate the present practice of tying aid purchases to the donor country, permitting recipients to buy in the cheapest markets, and donors to obtain the benefits of international competition.

The linkage proposal, in addition to substantially removing the risk of adverse balance-of-payments consequences, would thereby also avoid the need for present aid-tying practices. These practices not only

increase the cost of development aid to the developing countries, but also diminish the incentive in donor nations to fight inflation by remaining competitive.

The quantity of SDR-financed purchases made in a particular nation will be governed by that country's competitiveness as a supplier of goods and services demanded by developing countries. Price, the speed of delivery, and the availability of service are all important elements of a supplier's competitive position. Thus, there is no reason to expect that SDR's channeled to IDA through IMF by a particular industrial country will in fact be spent for exports from the same country. If an industrial supplier is highly competitive, SDR's donated by other nations may be used to purchase its exports. Conversely, if a donor is not competitive, it would be unlikely to earn SDR's that it or any other nation had given to IDA.

The spur to competition inherent in untied SDR-financed aid should produce an anti-inflationary effect in the developed countries to help counteract any inflationary impact arising from $540 million of additional export purchases by developing countries. Of course, fulfillment of the UNCTAD one-percent-of-GNP commitment implies that industrial countries must pursue fiscal and monetary policies so as to retain some reserve of unemployed resources after satisfying domestic consumption and investment demand and after any commercial export surplus. Otherwise, they would have no reserve capacity to produce gifts of goods and services for developing nations. But an additional development aid demand of one-half a billion dollars a year is not likely to be the inflationary straw that breaks the camel's back in the developed countries, with a combined annual GNP totaling over $2,000 billion.

(d) It would avoid the present need to budget and tax directly for development aid.

Present foreign aid practices, whether bilateral or utilizing a multilateral lending agency like IDA, require that the Congress and other national legislatures include foreign aid in regular budgets and levy taxes to pay for it. Under the linkage proposal, international monetary creation—already agreed to in the SDR amendment—would provide the financial wherewithal for this foreign aid. Each donor country must, of course, pursue expenditure, tax, and monetary policies to assure that its economy does not overheat beyond a full-employment-without-inflation level. The taxes so imposed would not be levied directly for foreign aid, but to reduce private spending to noninflationary proportions and to free resources for the production of goods and services given to developing countries.

(e) It would avoid the need for annual legislation inherent in bilateral aid-giving.

The U.S. Congress and many other legislatures now fund bilateral aid on an annual basis. Contributions to IDA and other international development banks are usually funded over three-year periods.

Annual funding, with its on-again off-again uncertainties, impedes the rhythm of economic development, and thus wastefully adds to its cost.

While the consent of Congress, and of other national legislatures, would be required to ratify the proposed linkage amendment, approval would be on a once-and-for-all basis, rather than annually. Precedents for such an open-ended congressional authorization are contained in the legislation setting up the Exchange Stabilization Fund of 1933; in the Federal Reserve legislation permitting the Federal Reserve System to engage in a continuing series of multibillion dollar "loans" and "swaps" for international monetary stabilization; and in the Special Drawing Rights amendment itself, which permits the Executive to agree to annual allocations of SDR's without further reference to Congress. Congress could at any time, of course, vote to rescind U.S. participation in the linkage amendment.

(f) It would meet the demands of developing countries for more assistance in a constructive way, and would offset the rich-man's-club aspect of the present SDR scheme.

The proposed link would help offset the tendency of the SDR amendment to distribute the preponderance of these new claims to wealthy countries. It would also help the industrialized nations satisfy their obligation to raise net financial transfers for development assistance to one percent of GNP.

If the SDR amendment is activated without modification, 64 percent of these newly created internationally acceptable claims will be distributed to industrial nations, and at no real cost to them. While logical arguments can be advanced to support distribution of SDR's strictly according to IMF quotas, this arrangement appears discriminatory. Once the facility is in operation, its discriminatory aspect will be more obvious, and may become a source of intensified antagonisms on the part of developing nations toward wealthy members of the IMF. Without altering the fundamentals of the Special Drawing Rights agreement, the distribution mechanism can be modified to permit industrial nations to *earn* some of their SDR's through exports of services and capital goods to developing countries, rather than receive all of them as manna from heaven.

Persistent unwillingness to earn even a portion of their SDR's in the face of a simultaneous failure to fulfill the pledge to raise net financial transfers benefiting developing nations to one percent of GNP, would suggest that the industrial nations are unconcerned about promoting economic development in any meaningful way. The one-percent-of-GNP commitment should be met. Modification of the SDR distribution process is a convenient way to do so.

5. Possible Objections to the Proposal

(a) "It would cut down the SDR's the wealthy will receive."

The answer to this objection is set forth above under 4(b): Each wealthy country would immediately receive 75 percent of its anticipated SDR allocation, and the wealthy countries together would very shortly receive the remaining 25 percent through export orders financed by SDR's. Thus the wealthy together will receive all of their expected reserve gains.

(b) "It will cause inflation in the donor countries by expanding demand from the developing countries."

This objection has been answered under 4(c) above: The modest additions to aggregate demand in the industrial world created by the linkage mechanism would be tiny in relation to the combined productive capacities of the donor countries. Moreover, there are adequate defenses for each individual donor country against any inflation-inducing demand that might be engendered by a linkage agreement.

If the developed countries are to fulfill their pledge to furnish development assistance equivalent to one percent of GNP, they must follow economic policies that will leave this quantity of output unutilized and available for transfer to developing nations. The proposal advanced in this report is intended to help accomplish this goal, while avoiding the threat of payments deficits. Ultimately the citizens of the developed countries must decide whether this objective shall be achieved, or whether the pressure of domestic needs will cause it to be abandoned.

It is true that if the level of national output is continuously maintained at the full-employment level, any expansion in the quantity of goods and services given to developing countries entails an equivalent sacrifice of investment or domestic consumption.

During periods of full employment, the suggested mechanism would oblige policymakers to design a set of monetary and fiscal policies making the required amount of goods and services available. But no industrial country is able to maintain full employment continuously. The entire industrialized world has never, except perhaps during World War II, produced at a level such that no further increase in real output was possible. At any given time, a reserve of unemployed resources will almost certainly be available in Japan, North America, or Western Europe.

When the industrial resources producing goods as aid would otherwise have been unemployed, development assistance cannot be considered a real cost. In fact, everybody gains. Economic growth in developing countries accelerates, and producers of exports also benefit. The exports are manufactured at no real cost to the nations supplying them. Moreover, export orders that bring unemployed labor and plant facilities into use create beneficial domestic multiplier effects, which in turn create still more jobs. Thus, even after making a gift of exports, the industrialized country extending aid may well benefit in terms of increased domestic consumption or investment.

By contrast, an industrial nation operating at capacity and suffering from persistent export surpluses and inflation can resort to a number of techniques to discourage additional export orders from developing countries. The government can informally urge domestic manufacturers to refuse additional orders or to state very long waiting periods for filling them. It can impose export taxes or statutory export embargoes, or it can revalue its currency upwards. The Joint Economic Committee's September 1968 and April 1969 recommendations for somewhat greater exchange rate flexibility would make such revaluations less painful than at present.

The persistence of substantial export surpluses in the face of domestic inflation indicates the failure of a country to introduce appropriate exchange rate adjustments to realize the benefits of its strong

international competitive position. These adjustments, by curtailing exports and stimulating imports, can play a major role in halting inflation. When a nation confronts persistent substantial trade surpluses combined with inflation, it cannot resort to expansionary policies to prevent further growth of its external earnings. Thus, the appropriate remedy is an exchange rate adjustment. The failure of such nations to adopt exchange rate adjustments when called for should not be used as an excuse for curtailing development assistance to poorer countries and for the failure of the industrial nations to live up to their UNCTAD pledge.

(c) "It will create pressures for issuing excessive amounts of SDR's, compromising their acceptability."

While there is no undisputed criterion that can be used to determine what would be the exactly appropriate quantity of SDR's to distribute, small differences in the quantity supplied will probably not have a noticeable impact on their acceptability. As is widely recognized now, the acceptability of SDR's does not depend upon any assets used to back them. In fact, there is no backing as such, and the acceptability of SDR's depends upon the commitment of IMF members to honor these instruments in the settlement of international payments surpluses and deficits.

The quantity of SDR's distributed under both the SDR amendment and the linkage proposal, should be determined solely according to the needs of the international monetary system, as determined collectively by the members of the IMF. Under no circumstances should the future usefulness of the SDR facility be impaired by excessive distributions, especially at the outset. The long-range benefits that the less developed countries could derive from a linkage mechanism would be seriously impaired if the acceptability of SDR's were undermined. One can therefore sympathize with those who favor a cautious approach until Special Drawing Rights have been accepted as a permanent feature of the international monetary system.

While the needs of the international monetary system should exclusively determine the amount of SDR's distributed, the 85-percent majority required by the SDR amendment to endorse the size of distributions assures that the linkage proposal would have no significant impact on the number of SDR's created. Since countries with only 15 percent of the voting power in the IMF can veto any distribution these nations consider excessive, the more likely danger is that not enough, rather than too many, SDR's will be created. Given this stringent veto provision, the danger that the developing countries could control or substantially influence the quantity of SDR's created seems far-fetched. We have not suggested any change in the process through which the size of SDR distributions will be determined. Our proposal entails only a change in the mechanism through which a preestablished quantity of SDR's would be distributed.

If the developing countries desired to expand the size of SDR-financed real resource transfers in their behalf, they would enjoy a much greater likelihood of success if instead of lobbying for an increase in the total quantity of SDR's distributed, they urged individual industrial states to increase the proportion of SDR allocations donated

to IDA. In the absence of any unalterable relationship between total SDR distributions and IDA donations, any attempt to increase development assistance through pressure for larger total distributions could be counterproductive.

(d) "It will cause legislatures in the donor countries to lose control over foreign aid"

This objection has already been answered under 4(e) above: While the assent of Congress, and of other national legislatures where required, would be necessary only in order to inaugurate the linkage amendment, Congress and the other legislatures could at any time vote to withdraw from, or to alter, the linkage proposal.

SUPPLEMENTARY VIEWS OF SENATOR PERCY

The SDR proposal is a good one because it provides more reserve capacity for the international monetary system. However, I would like to emphasize my concern that further, additional capacity must be generated for development assistance to developing nations, along the lines of this report. The need is immense; the requirement is urgent, if we are to achieve greater stability in the world. And I note with great disappointment that assistance to less developed nations has declined in relation to the gross national product of developed nations.

The situation also calls for increased efforts by the developed nations to meet their responsibilities in making capital available to developing nations, both bilaterally and through multilateral agencies. I personally believe that there are very strong arguments for increasing multilateral loan assistance. The record has clearly shown that bilateral programs, however efficiently managed, are vulnerable to political pressure or the equally damaging suspicion of political pressure. Less encumbered by political considerations, international agencies can insist on the application of objective economic criteria in the disbursement of loans and, equally important, enter into institutional relationships with recipient nations. Over the years, the World Bank, as the prime example of the multilateral approach to economic support, has built an enviable reputation for professional competence and dedication to development which removes from its recommendations the stigma of nationalistic self-interest which inescapably affects bilateral aid.

For those nations whose balance-of-payments prospects require easier terms than the World Bank itself can give, the Bank has often succeeded in "blending" conventional loans with concessional International Development Association credits in order to liberalize the terms of lending. However, the steady and alarming growth of debt-service costs among less developed nations argues strongly for a relaxation of a too restrictive policy in the Bank's approach to development finance. This relaxation could be accomplished by easing the Bank's commercial terms or by substantially increasing contributions to its IDA soft-loan window.

SUPPLEMENTARY VIEWS OF REPRESENTATIVES WIDNALL AND BROCK

It had been our hope that our subcommittee would have a unanimous report, but we feel the majority has wandered from the original objective of our country when we subscribed to the SDR creation. We believed then, and still do, that the new mechanism is vitally important toward the objective of free flow of trade and the ability of the nations cooperatively to stabilize their currency and improve their balance-of-payments position.

The majority report strays off course with its social emphasis at a time when the first objective has not even begun to function. No matter how worthwhile these objectives, they can never be obtained without proving the program as initially envisaged. Our own beliefs are expressed in the following supplementary views.

The chief purpose of the SDR facility is to add a new, supplementary reserve element to the international monetary system. This purpose responds to an immediate and critical need for increased reserve capacity to support the high level of trade and capital movements among members of the International Monetary Fund. It also paves the way for development of this capacity still further as the ever-growing volume of world trade continues its course. This central purpose of the SDR facility should not be underemphasized, lest the need for increased world reserves be relegated to a lesser importance than it deserves.

The success of the proposal to link reserve creation and development assistance in fact depends upon the unqualified acceptability of SDR's as a reserve asset. Throughout the negotiations on the amendment, the drafters were careful not to compromise this acceptability. It follows that we should first ensure the viability of SDR's as a reserve asset before adapting them to a purpose for which they were not originally intended.

We believe, therefore, as a matter of ordering priorities and of guaranteeing that the important problem of world liquidity is effectively dealt with, that the Board of Governors should defer consideration of this proposal until the SDR facility has clearly demonstrated its viability. The end of the first 3-year cycle may be an appropriate time for consideration. This delay should give the Board the opportunity to assess whether the facility can actually perform its task of increasing world liquidity and, consequently, whether it can be a suitable vehicle for expanded development assistance.

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