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U.S. FOREIGN AID AND THE PRIVATE SECTOR: IS PARTNERSHIP POSSIBLE?

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SUBCOMMITTEE ON TRADE, PRODUCTIVITY, AND ECONOMIC GROWTH

OF THE

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CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON TRADE, PRODUCTIVITY,
AND ECONOMIC GROWTH OF THE
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 6226, Dirksen Senate Office Building, Hon. William V. Roth, Jr. (chairman of the subcommittee), presiding.

Present: Senator Roth and Representative Richmond.

Also present: Kent H. Hughes and Marian Malashevich, professional staff members.

OPENING STATEMENT OF SENATOR ROTH, CHAIRMAN

Senator ROTH. The subcommittee will be in order.

I am very pleased to have the opportunity to chair this morning's subcommittee hearing on the administration's announced policy of placing greater reliance on the private sector in our foreign economic assistance programs.

It is no secret that foreign aid enjoys less than enthusiastic support in this country. Some regard foreign aid as an international give-away program from which the United States derives little tangible benefit. And as we cut the Federal budget more deeply, this skepticism has grown even stronger.

Frankly, I have long thought that one of the major difficulties with our foreign aid is that we have set our goals too high. To read the Foreign Assistance Act, one has the impression that foreign aid can solve all the world's problems. The language of the act may well have been influenced by the success of the Marshall Plan in restoring Western Europe to economic health. But the success of the Marshall Plan was ultimately due as much to the talents and abilities of the Europeans themselves as to our financial and technological assistance. Our aid certainly speeded up the process—and helped prevent Western Europe from being absorbed into the Soviet Empire—but few can doubt that a free Europe, or Japan for that matter, would have remained economically crippled forever.

Today, we cannot afford the luxury of a mythical "Marshall Plan" mentality. At a time when we are struggling to put our own economic house in order, we must face facts squarely. And the fact is that simple transfers of wealth, or even of technology, will have no long term beneficial effect unless the developing countries have the will and capacity to marshal their own human and natural resources.

Another fact that should be recognized is that those developing countries that have enjoyed the greatest success have relied heavily on private enterprise and market mechanisms to stimulate economic growth with considerable equity. The success of the so-called newly industrialized countries, especially around the rim of the Pacific, suggests that capitalism remains the most efficient means for liberating the productive energies of mankind.

A final fact is that the policy and practice of many of our strongest economic competitors is to tailor their foreign aid programs in support of their export trade, overseas investment, or resource-development objectives. These objectives are in turn closely related to domestic concerns such as employment, productivity, or inflation.

In contrast, we in the United States have continued to act as if the world is playing by our rules. We have tended to put foreign aid, trade, investment, and domestic policy considerations in different policy compartments as if they had no effect on one another. In reality, these policies are very interrelated, and our refusal to recognize this has caused us to lose out in competition for fast-growing Third World markets.

There is, however, doubt in the minds of some people as to whether a private sector orientation can really work. Many thoughtful people question whether the U.S. Government, business, and labor can cooperate effectively. Others do not want an allegedly pristine altruism of U.S. aid polluted by other policy considerations. Still others would like to ignore the intense competition from Europe and Japan and keep the Government entirely out of the international economic arena.

My own preference is for a practical and pragmatic approach, which I think the administration's announced policy represents. I would point out that the Foreign Assistance Act provides for both a basic human needs orientation and—and I want to emphasize the word "and"—the encouragement of free enterprise and private participation in foreign aid programs. Just let me quote from section 601 of the act: "The Congress of the United States recognizes the vital role of the free enterprise in achieving rising levels of production and standards of living essential to economic progress and development." The act goes on to say that "It is declared to be the policy of the United States to encourage the contribution of U.S. enterprise toward economic strength of less developed, friendly countries, through private trade and investment abroad, and private participation in programs carried out under the act (including the use of private trade channels to the maximum extent practicable)."

It is with this in mind that I welcome statements by administration spokesmen that our foreign aid programs and policies will place greater emphasis on private sector initiatives and market mechanisms to stimulate growth in the developing world. It seems to me that this approach will have a better chance of not only meeting the aspirations of the Third World countries for economic development but will also better serve other U.S. economic objectives.

Finally, I would like to note that the administration has a golden opportunity to demonstrate that it is indeed possible for government and the private sector to cooperate in the service of our national interests. Should this experiment succeed—and I sincerely hope that it will—it could serve as a model for cooperation here at home as well.

Before introducing our first witness, I have an opening statement from Senator Hawkins, who cannot be here today, that will be incorporated into the record.

[The opening statement of Hon. Paula Hawkins follows:]

OPENING STATEMENT OF SENATOR HAWKINS

Welcome to the subcommittee, Mr. McPherson.

I think your appearance is most timely and I think your mission of implementing the President's policies for encouraging private sector development, in developing countries, is most worthwhile.

America's aid programs must depart from the past practice of simply shoveling money to Third World countries. We must consciously link foreign aid to other U.S. policy interests. As well, our policy must find a middle ground between close Government supervision of aid recipients and "Let the private sector do it all."

We must carefully examine how much of a role the private sector can and should play in the development process. In other words, we must examine all policy options that could foster, in developing countries, market-oriented approaches which would enable them to create their own wealth.

Judicious use of our foreign aid can improve America's export markets and strengthen our international interests. We need to develop the balance appropriate to U.S. economic and security interests among AID special credits, and Export-Import Bank financing and tariffs. I am aware that tariff negotiations under the general system of preferences could result in decreasing U.S. tariffs on agricultural products from developing countries.

In the spirit of "trade not aid" we will expect that concessions given will be matched by market opportunities received for our own products.

In summary, we must put aside past hopes that aid will somehow "trickle down" to the masses. Instead, we must realize that democratic self-determination is inseparable from economic development.

I view the private sector as an integral, essential contributor to the development process. We must encourage broad-based economics, broad in terms of income and wealth distribution. America's trade policy, development policy, and foreign policy must be linked together to further these ends. Thank you.

Senator ROTH. As our first witness today I take great pleasure in welcoming the Administrator of the Agency for International Development, Mr. Peter McPherson. I know he is well prepared to share with us his ideas and plans in this important and complicated area. I see that Mr. McPherson is also accompanied to these hearings by Mrs. Elise du Pont my good friend and constituent from my own State of Delaware.

Mr. McPherson, please proceed.

STATEMENT OF HON. M. PETER McPHERSON, ADMINISTRATOR, AGENCY FOR INTERNATIONAL DEVELOPMENT

Mr. McPHERSON. Thank you, Mr. Chairman. I'd like to, if I might, enter into the record my prepared statement and let me summarize for you that statement.

Senator ROTH. Without objection.

Mr. McPHERSON. First, let me say how pleasant it is to be here. I was in the private practice of law for several years and have long been very interested in the whole concept of developing private enterprise, and so to be able to talk about it here today is really quite pleasant.

We think that we need to do a great deal in this area. We think that it is necessary because first, there simply is not enough foreign aid money to approach development problems in a traditional fashion, if indeed the traditional fashion alone was nearly enough. Second, it is clear to us that private enterprise is an integral part of development in most countries and because of that we have done very much in that area as well.

Let me tell you an experience from my own past and a story of how something that we have done since I have come in that exemplifies the thrust of what we are after.

When I was growing up in Michigan, my father at one time talked to a local cannery company about canning tomatoes and he and his neighbors decided that they would get into that business. The cannery company provided some money for fertilizer, plants and gasoline, and so forth and provided the know-how to grow tomatoes and my father and his neighbors—and Campbell Soup followed this model throughout the country for many years—proceeded to get into a business that they had never known before due to the technology transfer, from Campbell Soup. It was private enterprise doing very much the kind of thing that government-to-government programs often get into and do not do so well. It was a very successful program and my father and his neighbors, through many years, grew a lot of tomatoes. That is the sort of thrust I think we can do in a lot of places, incidentally, and we are looking at a lot of options.

Just recently, a very successful little project that exemplifies our thrust is in Costa Rica, which like many countries, has a need for hard currency to buy parts for its factories and all types of business needs. There is a real dearth of private capital to do these things. We are in the process of putting together a loan whereby we will loan $10 million to a privately organized bank, the only private banking situation now in Costa Rica.

That bank will, in turn, be able to multiply that money 10 to 1 through private sector loans. The $10 million will not be guaranteed by the Costa Rican Government by the way. The net impact is that with that $10 million—not a lot of hard currency—we are going to assist a private sector that is starving for currency to do some good things. I wanted to start off by telling you the thrust of what we are trying to do in concrete terms and this is an example of what I think is, to use your terms—and I think those are excellent ones—a practical and pragmatic approach to this whole area.

Let's talk in broader conceptual terms about how that might be done. First, it is clear to us that the policies and programs of the countries themselves are critical for private enterprise to work. I think we all know that. If the country's environment is such that private enterprise cannot make money, cannot survive, then anything that an outside government tried to do to stimulate it is not going to be successful. Therefore, it is critical as we proceed with our programs in these countries to have a constructive dialog about a whole range of policies in those countries, and we think that this dialog can enhance the private enterprise environment.

We think that we can be a front line for some developmentally oriented private enterprise projects in those countries. Our AID missions have very senior contacts within virtually all governments with which we work. So often, a bureaucracy in a host government is a real problem, and we are finding that one of the services we can best render to private enterprise in those countries is to try to assist U.S. firms in their work with a bureaucracy.

To exemplify this whole new thrust, we have organized a new bureau, the bureau for Private Enterprise. To put that bureau together we have taken several steps that I think can make it a good, strong bureau. It will take some time but, in fact, it's coming along and we expect to have in the neighborhood of $10 million for that bureau to work with. I do not think any large amount will be spent in any one place, but the bureau can use that $10 million for seed capital. It is very important for it to have some direct control over resources itself, so we are in the process of transferring to this new bureau various centrally funded AID projects that have a private enterprise orientation. So everything with that orientation will be in this bureau, such as the IESC program, to which AID gives about $5 million a year. This is a program which sends retired senior executives to various areas to help the private enterprise groups there. This is very good program, I might add.

We expect this new bureau to coordinate the other private enterprise sector interests of the Agency. For example, the Director of IDCA, the Trade and Development program reports to me. Chris Holmes, who is here today, heads up that program and reports to me, but he is also under the direction and coordination of the Private Enterprise Bureau. I also wear the hat of being the chairman of the board of OPIC and staff coordination between AID and OPIC is handled through the Bureau for Private Enterprise. OPIC, of course, is a separate program and I believe that Mr. Nalen will be testifying here today. The overall coordination and policy development functions in the private enterprise area will, in sum, be in this new bureau.

More concretely, we have targeted 10 countries where we think there are some real private enterprise opportunities. I want to do this in many countries beyond the initial 10, but it seemed best to me to first target some countries that might really work. I believe that developing those first few to make sure something really evolves is the best way to run—by walking first now.

The 10 countries are Indonesia, Sri Lanka, Thailand, Pakistan, Kenya, Ivory Coast, Zimbabwe, Jamaica, Costa Rica, and Egypt. In due course, we expect to have targeted a figure for private enterprise activity in each one of these countries. We are now in the process of working through the fiscal year 1982 budget once more. This budget had previously been submitted to Congress but, as you know, the President, to address the overall economic situation in this country, has directed a reduction of the AID program and we are now in the process of developing a new budget. In addition, we also need to consult with our authorizing and appropriating committees in terms of what kind of target figure we will have for each of these countries.

But, the point is that we expect to have a targeted amount of money for private enterprise activity for these 10 countries and, no doubt, we will be adding other countries as well. These programs that are developed within these countries—and good projects can be arranged for each one of these countries—will be programs which, in concept, will be agreed on between our mission in the field, the host country government and the Private Enterprise Bureau.

I want the Private Enterprise Bureau to have an overall policy review function but not get mired in the administration of projects. I felt, incidentally, that placing increased management responsibilities in the field was a critical part of making our overall foreign aid program work. Indeed, we are sending what we are calling reconnaisance missions to each one of these countries to take a look at what kind of projects we might develop in the private enterprise area. The first one of these missions leaves Wednesday and is headed by Ed Harrell, the Deputy Assistant Administrator for the Private Enterprise Bureau. And such people as George Ferris, Jr., of Ferris & Co. here in town, will be going on that trip.

These missions will include some senior government people and very senior private enterprise folks who can understand what a balance sheet is really worth. There are a number of projects that they will be exploring. I mentioned, for example, the Costa Rica project and the Trade and Development program will be doing a whole range of feasibility studies. We have several million dollars in the TDP budget, but I think we can do even more through individual AID mission projects.

There are other intermediary financing facilities of which you perhaps are aware. The venture-capital organization in Latin America that we have just recently funded, called LAAD, is the type of activity that we expect to do in a cautious, careful way, not so much for the financing of U.S. exports but for extending credit under certain circumstances. We are interested in cofinancing projects of a nature such as you just referred to, and I could go on in this area.

I'd like also to mention that we expect to put quite a lot of focus on agribusiness. We, as an agency, have quite a lot of expertise in the agribusiness area. Our association with the ministries of agriculture is a very good one and we think that we can do a particularly good job there. Moreover, it seems to me that an agribusiness orientation is helpful in the whole approach of looking at what poor people in a country are doing and having our AID program be of maximum help.

In conclusion, gentlemen, I strongly feel—and I have studied and thought about it a great deal, not only since I've come to AID but even before—that this whole private enterprise area is one where AID can have a major impact, that we can stretch our moneys further than they have been in the past, and that, in fact, there's not going to be economic growth, the growth needed for jobs and adequate food production in these countries, unless a successful private enterprise program is undertaken—undertaken first and foremost by these countries, but facilitated, in part, by us. Thank you very much.

[The prepared statement of Mr. McPherson follows:]

Prepared Statement of Hon. M. Peter McPherson

Mr. Chairman, I greatly appreciate this opportunity to address the subject of these hearings: "Aid and Private Sector: Can they work together?"

This Administration believes that A.I.D. and the private sector can and must work together in order to generate the kind of long-term development in the less-developed countries that results in strong and sustained economic growth and human progress.

President Reagan outlined U.S. trade and investment initiatives before the World Affairs Council of Philadelphia last week. These initiatives are designed to generate development and growth in the Third World through the force of what the President earlier called "the magic of the marketplace." These initiatives are significant because the less-developed countries now, more than ever, understand the benefits inherent in a strong and viable market economy and the need to expand employment opportunities through a vigorous competitive private sector.

Creation of the Bureau for Private Enterprise in the Agency for International Development, headed by an Assistant Administrator, Elise du Pont, is structural evidence of the new policy direction we have begun to implement. Less emphasis will be placed on transfer of funds, of taxpayer's dollars. Greater emphasis will be placed on the transfer of those things that generate resources -- the technology, skills knowhow and capital of the U.S. private sector.

A.I.D.'s mandate under the Foreign Assistance Act encourages private sector activity. Our new emphasis seeks a partnership of government and the private sector in the total development process -- not just involvement at the implementation stage. One important element in A.I.D.'s policy is to encourage recipient countries to pursue sound economic policies. These self-help measures might include, for example, pursuing realistic exchange rate, increasing aggregate private investment, developing intermediary financial ~~benefits~~, encouraging fiscally productive taxes, expanding technical training and the like. I will look to the Bureau for Private Enterprise to formulate and coordinate private sector policy within A.I.D.

It is our goal to establish a relationship between the U.S. private sector and private sectors in the developing countries. That is the best approach, in our view, for technology transfer, employment generation and the generation of resources. Economic development in most Third World countries, in fact, hinges on the vigorous interaction between local and foreign private sectors.

Before proceeding further, Mr. Chairman, I would like to stress that while today's presentation focuses totally on A.I.D.'s involvement with the private sector, A.I.D. most certainly has a continued commitment to furthering development by supporting such other key sectors as health, education and agriculture.

I. Bureau for Private Enterprise

It is important, Mr. Chairman, that I take a few minutes to describe the structure and responsibilities of this new Bureau. In order to achieve the objective of facilitating private sector involvement in the developing world, we believed that it was necessary to create a special structure which would not only visibly symbolize our commitment to private enterprise, but which would also, and more importantly, ensure that A.I.D. developed and implemented new programs and policies.

The Bureau consists of two divisions: One houses the two organizations which have played a key role in A.I.D.'s past involvement with the U.S. private sector, namely, the Office of Business Liaison and the Housing Investment Guarantees Office. Through this division we have the benefit of A.I.D.'s past involvement with the private sector.

The other Division consists of two new units, the Office of Investment and Office of Policy and Project Review and Mission Support. These Offices will be staffed by outstanding professionals. We are now in the process of bringing into A.I.D. a small team of people who are skilled in such fields as investment and capital market formation. In many ways, they and the programs and policies which they will implement represent a prototype for an A.I.D. of the future -- an A.I.D. which will rely increasingly on leveraging relatively small amounts of public sector funds to attract greater amounts of private sector resources to accomplish goals which in the past have fallen to too great an extent on the shoulders of the taxpayer. Moreover, this Bureau will also use more creatively A.I.D. project funds to help support projects develop by both indigenous and U.S. private sector. The Bureau will work closely with private sector liaisons designated in each of the bureaus.

Finally, the Bureau for Private Enterprise will have the lead responsibility for coordinating and relating to the activities of two other agencies which fall within my purview, namely, the Trade and Development Program which reports to me in my capacity as Acting Director of the International Development Cooperation Agency (I.D.C.A.) and the Overseas Private Investment Corporation (O.P.I.C.) of which I am the Chairman of the Board. The Bureau for Private Enterprise will also be responsible for coordinating with the aid activities of the International Finance Corporation (I.F.C.). Mr. Nalen, President of O.P.I.C. will also be testifying today on O.P.I.C.'s role in fostering trade and investment.

Trade and Development Program (T.D.P.)

The T.D.P. is unique and therefore requires further elaboration. This program plays a special role in fostering the development of countries while also promoting trade opportunities for the U.S. The Fiscal Year 1982 budget of the program under the Continuing Resolution is $4 million. Although this is relatively small, particularly in comparison with similar programs carried out by our major competitors, such as Japan, France, and Germany. The program has a tremendous multiplier effect for U.S. exports.

Essentially, the program seeks to tie U.S. firms into large-scale projects which will be financed by developing countries. Since many of the projects T.D.P. is interested in run into hundreds of millions of dollars, the export potential for the United States is very high. The Trade and Development Program is thus an ideal way in which to foster a mutually beneficial relationship between the U.S. and the developing world. The following, Mr. Chairman, are some of the main approaches which the Reagan Administration plans to take to facilitating U.S. trade through the T.D.P.

-- First, T.D.P. funds will be made available at the most critical stage in the planning process of a development project -- namely, at the point where U.S. firms are in the final stages of the bidding process for feasibility studies for large-scale projects. For example, we plan to replicate a major success T.D.P. achieved early this year in the Philippines. It was brought to our attention that several countries had offered to conduct, free of charge, a feasibility study for a major steel mill which the Government of the Philippines planned to construct. T.D.P. learned that several U.S. firms were competing for this study and concluded that, given the offer of other nations to conduct the study free, a U.S. firm would most probably not win the bid for the feasibility study. We in turn offered a grant of $300,000 to the Government of the Philippines to cost-share on the study if a U.S. firm would be awarded the feasibility study contract. The Philippine Government agreed and U.S. Steel was awarded not only the T.D.P. financed $300,000 contract but also an additional $4.8 million contract from the Government of the Philippines.

-- Second, we will concentrate increasingly on the coal and alternate energy sectors. Developing nations desperately need to move away from oil-based energy sources to other sources of energy. Both the U.S. government and the private sector have devoted huge sums of money to develop new energy technologies with the result that the U.S. is highly competitive in these areas. T.D.P. is very active in marrying the needs of the developing nations with available U.S. technology and the U.S. firms which can supply it. Moreover, by helping a nation to convert its power base from oil to energy sources such as coal -- as T.D.P. is now doing in Jamaica -- we also help open export markets for U.S. coal.

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-- Third, we will attempt to use T.D.P. to facilitate access to natural resources of interest to the U.S. Section 661 of the Foreign Assistance Act, which authorizes funds for T.D.P., specifically encourages the use of T.D.P. funds in this area. In light of our nation's reliance on developing nations for minerals and metals of strategic importance to the U.S., we are reviewing with the U.S. Geological Survey, the Bureau of Mines and other concerned agencies how a portion of T.D.P.'s budget might be used to help nations develop the resources we badly need.

II. Private Sector Approach

I would now like to address our strategy for furthering trade and investment to be carried out by the new Bureau for Private Enterprise.

Recognizing that limited A.I.D. funds require a targeted approach, the Bureau for Private Enterprise, working with A.I.D.'s regional bureaus and missions abroad, has selected several countries to receive initial attention -- Indonesia, Sri Lanka, Thailand and Pakistan in Asia, Ivory Coast, Kenya and Zimbabwe in Africa, Jamaica and Costa Rica in this hemisphere, and Egypt in the Middle East.

Criteria for selection included whether the targeted country had a private sector that was recognized and supported by the host government, whether it was strategically and commercially important to the United States, and whether the U.S. already had a presence there in the form of an A.I.D. mission.

For each country we expect to target a portion of 1982 or 1983 funds for private sector-related activities; this target will fall within the existing A.I.D. overall country budget. As to the specific amounts, we are now in the process of consulting with the House and Senate Appropriations Subcommittees on Foreign Operations, the Senate Foreign Relations Committee and the House Foreign Affairs Committee. This is not merely ratification but an exchange of views and no numbers can be given until consultation is completed. As to the internal A.I.D. mechanism for approving the projects, the project concept will be jointly agreed upon by the A.I.D. country mission and the Bureau for Private Enterprise.

On Wednesday, the first of seven reconnaissance missions, headed by an A.I.D. official, but including business representatives and financial and investment experts, will leave for Indonesia to explore investment and other development opportunities. The team will include George Ferris, Jr., Chairman of the Board, Ferris & Company, Washington, D.C.; Dr. Joel Godhard, a prominent Washington consultant on business strategies; Mr. Ron Katz, an Indonesian-speaking lawyer and Rhodes Scholar with a San Francisco law firm; and Mr. R. Jordan, a well-known agribusiness specialist. Their findings will determine exactly what A.I.D. may be able to do to stimulate private sector activity in that important nation.

Missions are also scheduled to go to Kenya, Sri Lanka, and Thailand before the end of the year. A.I.D. will also be represented on O.P.I.C. missions scheduled for Jamaica and Zimbabwe between now and February 1982.

The purpose of the private sector reconnaissance missions will be three fold: to determine, one, whether the country has an active and innovative private sector which wishes to expand or diversify investments in job-creating enterprises; two, whether the government has created the climate and infrastructure in terms of policies, procedures and financial markets to support expanded private sector investments; and, three, what are key opportunities, ideas or proposals for private sector investments that are developmentally oriented and where A.I.D. in some way could facilitate the investment being made. In this latter case, we see a very important role for U.S. private sector involvement, either as a joint partner, or as a source of technology, marketing and managerial skills or other mutually advantageous arrangements.

These missions will be assisted by ad hoc advisers primarily from the private sector, in thinking through both the opportunities and the problems of assisting the targeted countries in private sector development. A.I.D. will then suggest to the government and to the A.I.D. mission how we, or the U.S. private sector, might be of assistance, either through advisory services in the policy area, capital market development, or in training to facilitate private sector development in that country. A.I.D. will also suggest what we perceive as good developmentally oriented private sector opportunities.

The Bureau will be working closely with O.P.I.C. which has considerable experience in identifying investment opportunities. However, unlike O.P.I.C., we will engage in actually devoting U.S. financial resources now managed by A.I.D. to help further U.S. and indigenous private sector involvement in the development process.

A.I.D.'s subsequent role in developing these opportunities further may be no more than bringing the parties together or financing some preliminary marketing or pre-feasibility studies that would clarify the investment opportunity. I want to stress that A.I.D. will take a more active role in assessing the various constraints affecting the success of a particular project and will suggest to the potential investors how they and we might put the various pieces together to make it a good investment.

In so doing, we will also examine host country policy affecting the investment and where necessary make appropriate recommendations to the host country so as to facilitate the investment.

We could envision A.I.D. in some cases making a financial contribution to particular developmentally oriented projects, either through financial intermediaries that we would support, or more directly. If training or small infrastructure investments were particularly important in generating a significant amount of new private sector investment, e.g., processing and marketing agricultural produce, A.I.D. might become involved in financing more traditional A.I.D. programs to meet that need. We envision some projects, when fully developed, being managed primarily by the private investors but with A.I.D. oversight. I believe there are many cases in the developing world where the U.S. investor in particular would feel more comfortable in terms of assessing his risks and making an investment decision if the U.S. government had an involvement in the project in some way. Depending on the circumstances, A.I.D.'s role might be as a facilitator. In others, we might be a co-financer with a private bank, the International Finance Corporation (I.F.C.), the World Bank or other multilateral or bilateral and donor agency.

An illustrative project we might package and finance is as follows: A developing country desires to export packages or processed vegetables, rather than fresh vegetables, to a neighboring high-income country. Productivity per hectare is relatively low by international standards; use of water per irrigated hectare is high. However, agriculture pricing policy provides the right market signals to the farmer and labor costs in the country compared to alternative suppliers of similar products low. What the country lacks is packaging, processing and export marketing know-how. The entrepreneur in the developing country has money and managerial talent but lacks knowledge of cost accounting, training of labor in the vegetable processing field and marketing. This is an opportunity for A.I.D. to help put the project together combining new production, marketing and training technology which the U.S. can offer with indigenous resources of land, labor and entrepreneurial talent.

An American partner in this project may offer the technology for higher yield production of vegetables for the export market -- seed, irrigation, plant protection -- which would be offered to private farmers to produce on contract to the processing plant. A guaranteed quantity and price before planting would reduce the farmer's risk and be an incentive for him to use the new technology offered. The American partner may also make an equity investment in the processing plant, provide cost accounting and training advice and perhaps undertake the marketing of the processed product either as a joint partner or on contract. A.I.D. may be involved directly or through an intermediate institution in putting the project together, doing studies, providing credit for the farmers, financing pilot demonstration plots on new technology or more efficient use of water, or take a financial position in the processing plant for the first few years to get the project going and arrange for training.

I should note, Mr. Chairman, that this method should be of particular interest to you as it has been used in this country to revolutionize the broiler industry -- an industry with which you have considerable familiarity. Moreover, Campbell Soup and Heinz have used this approach quite successful in their respective industries.

Let me turn now to the work we are doing with the International Finance Corporation. The Bureau for Private Enterprise is developing a close working relationship with the International Finance Corporation (I.F.C.), the World Bank arm that promotes private enterprise projects in developing nations, where we find a common purpose. The Bureau will work with the I.F.C. on capital market development and job-creating investment in the targeted countries. In the action program enunciated by President Reagan last week was this reference:

> "We seek to increase co-financing and other private financing with the multilateral development banks. We want to enhance the International Finance Corporation activities -- which fosters private sector debt and equity financing of investments in the developing countries. Its program is increasing in both size and diversity and the bulk of I.F.C. projects are privately financed in the developing countries from domestic and external sources."

The Bureau will also manage a program to seek out and respond to particularly attractive developmentally oriented private sector opportunities outside the framework of the specific country allocations. Agribusiness, training, co-financing with development banks or venture capital organizations and the I.F.C. will be a particular focus. The Bureau will also have the responsibility for managing the International Executive Service Corps(I.E.S.C.) centrally funded project to the Bureau.

As I'm sure you are aware, this private and voluntary organization, comprised of retired executives, plays an important role in augmenting A.I.D.'s manpower. We are honored that they are a part of this team effort. We are also reviewing other centrally funded projects which we may move to the new Bureau as appropriate.

In developing its program, the Bureau for Private Enterprise will benefit from the advice of a Private Sector Advisory Council, drawn from all segments of the private sector, which is now being formed.

III. New Approaches

In addition to the work to be undertaken by the new Bureau for Private Enterprise and the ongoing A.I.D. projects, we also plan to undertake the following steps:

-- Expand A.I.D.'s Trade and Development Program efforts to conduct feasibility studies and other planning services for development projects. Missions will also expand their funding of studies to identify and encourage private sector development and U.S. exports;

-- establish significant co-financing programs for development projects with private commercial banks and venture capital firms, both U.S. and LDC-based. I would like to stress, Mr. Chairman, that in referring to co-financing, we are not talking about mixed credits for export promotion in the context of the activities of the Export-Import Bank; the matter of mixed credits is now under review by the Administration. Rather, in referring to co-financing, we are talking in terms of joint ventures to stimulate private investment in productive enterprises. The World Bank and most bilateral aid agencies have also found that co-financing, whether in the form of parallel or joint financing, is an important means of drawing private debt capital into development projects. By "blending" concessional funds with private credits, two principal benefits are realized: (1) scarce appropriated funds or "stretched" or "leveraged" and (2) private funds are channeled toward developmentally sound projects or transactions. On an ad hoc basis, A.I.D. in the past has co-financed projects with other bilateral and multilateral development agencies. We intend now to develop a program to encourage co-financing with private capital.

-- Expand support of intermediate credit institutions, such as local private development banks, to provide capital to developing country private sector enterprises. For example, we are working with the private sector to establish a privately-owned development bank in the Eastern Caribbean.

-- Increase support for managerial and technical training oriented to the private sector.

-- Work in close cooperation with appropriate institutions in providing advisory services to developing countries in the following areas: a) capital market development; b) investment policy; c) industrial and agribusiness policy.

-- Stimulate private investment through development of investment opportunities in conjunction with O.P.I.C. guarantees and Export-Import Bank credits. We would envision a limited A.I.D. role in debt financing, either through the host country or direct lending to U.S. investors against bonds or debentures.

-- Help alleviate bottlenecks in the marketing of LDC products. For example, two projects are in formative stages to facilitate inter-island marketing in the Caribbean. One involves support to a privately owned regional shipping company which would service the small Eastern Caribbean islands. The other is a regional agricultural marketing facility which would trade in fresh produce in the region.

-- Increase investment promotion activities. In this regard, international conventions are planned to link small and medium businesses from the U.S. with Caribbean businesses for the purpose of launching new joint ventures and transferring technology. A Caribbean project entails project identification activities, linking likely investing partners, and providing follow-up support to facilitate investment decisions. Also in the Caribbean, we are funding a project development program which will finance resident industrial development advisers. One of the primary functions of these advisers is to identify and appraise business ventures in the small Eastern Caribbean islands. The advisers will help identify potential U.S. investors and facilitate business transactions.

IV. Newly Approved A.I.D. Projects

Early this year, I undertook a comprehensive inventory of all A.I.D. private sector activities. The following is a highlight of those planned or ongoing activities which I believe merit continued support and, in many cases, replication.

In Latin America and the Caribbean, we have developed and funded a number of projects this year which strengthen private sector institutions and support private financial mechanisms.

In Jamaica, after the election of a new government dedicated to the free market under Prime Minister Seaga, the United States was the first nation to offer assistance, providing "bridge" financing to fill the gap pending larger-scale support from the International Monetary Fund (IMF).

Our long-term objective in Jamaica is to strengthen key sectors of the Jamaican economy in order to stimulate production, exports and jobs. We and the government have been working closely with the Rockefeller Committee in identifying opportunities for private investment to create jobs and expand foreign exchange earnings. Through the offices of the Rockefeller Committee, and financed by A.I.D., four American private sector advisers screened 408 investment proposals received by the Jamaicans. For those that looked promising, the consultants made contacts, initiated a dialogue and helped bring interested parties together. We expect new and significant American and Jamaican investments will result from this pioneer effort.

The A.I.D. Mission also recently responded to concerns raised by the tourism subcommittee of the Rockefeller Committee about the ability of hotels in Jamaica to respond adequately to an expected good winter tourist season. The International Executive Service Corps (I.E.S.C.) and private consultants financed by A.I.D. reviewed the situation and made recommendations which may result in the hotels better preparing themselves for this tourist season.

In Costa Rica, we have made a $10 million loan to the privately owned Agro-Industrial and Export Bank of Costa Rica (BANEX) to promote non-traditional exports from that country. Credit, banking, and marketing services are provided to help Costa Rican producers sell their products abroad. The A.I.D. loan is structured to leverage an equivalent amount of private commercial bank lending to BANEX.

A recent $6 million loan to the Latin American Agribusiness Development Corporation (L.A.A.D.) will allow that organization to finance some 45 agribusiness projects expected to create 10,000 jobs in Central America. This program also encourages a co-financing arrangement whereby L.A.A.D. will match the A.I.D. loan with $6 million in private bank borrowings. With the A.I.D. and private bank loans and L.A.A.D.'s own resources, more than $29 million will be available for agribusiness projects in Central America. I should note that we are now considering replicating the L.A.A.D. approach in Africa.

In the <u>Near East</u>, a major development, which I personally approved, is the establishment of a new $25 million Trade Financing Facility to enable U.S. companies who are low bidders to compete more favorably on international tenders where better terms of financing are necessary.

In closing, Mr. Chairman, let me stress our deep appreciation for the interest you and your subcommittee have shown in our program. Today's hearing occurs on the eve of the Cancun Conference where President Reagan will again stress the vital role of private enterprise in the development process. I will be joining our delegation to the summit and I can assure you, Mr. Chairman, that we will very much keep in mind the thoughts and advice you will have offered today on the interaction of aid and trade.

Senator ROTH. Thank you, Mr. McPherson. I would inform you, as well as the other witnesses, that if any of the members of the subcommittee have any questions, they can submit them to you in writing within the next week and ask that you reply to them.

Mr. MCPHERSON. Of course.

Senator ROTH. First, I would like to congratulate you. I have quickly looked at your prepared statement and I think it represents a very fine and forthcoming policy statement and represents a new approach which I think is critically important.

Let me start out by saying that I strongly believe that we need to develop a new approach to foreign aid. I recognize that this is going to meet a lot of opposition and antagonism by those who want no modification, but it does seem to me that it's critically important that we have a combination—as I said in my opening statement, and I want to underscore—a combination of a continuation of much that we have done in the past in the area of providing food and providing assistance with respect to the world population, and some new approaches to foreign aid. I think it's important to understand that increasingly in this country, and certainly within the Congress, many people feel that foreign aid has not represented our best interests beyond a humanitarian approach.

I think as you look around the world, as you look at Asia, that the greatest progress for the people has been made around the rim of Asia. The reason for that is that they have used, in large measure, the private market and created an atmosphere of welcoming help from the private sector abroad. So that I think that the real way to make progress is by the private sector approach.

One of the interesting questions, of course, is going to be how much can you use the same success that has been achieved not only in Japan but Korea, Singapore, and Hong Kong and nations in other parts of the world. So I congratulate you for taking a new look and trying to introduce some new approaches.

I might say that I also think that this approach is important because one of the problems, as has been said many times, is that foreign aid has no constituency here in America because no one saw where it was doing much direct good. Now when we look at what other countries have done, in the case of Japan and many other countries in Western Europe, France in particular, they have used foreign aid as a means of promoting trade and exports and that can be, as I pointed out, very beneficial to the host country because what we are trying to do is to promote long-term development that will help the people in those areas. In fact the only countries where the common people have made real progress are the ones that I've mentioned. Their standard of living has grown considerably over the last 10 or 20 years.

So if we can structure our aid or part of our aid so that it's helping our economy, our employment, it seems to me that you can build a constituency for the entire program, including the humanitarian aspects; I think we have a marvelous opportunity here of moving foreign aid in a new direction which will benefit both the people we are trying to help as well as our own economy. It will also help you develop a constituency which will enable you to do some of the things that need to be done.

I would say, Mr. McPherson, that I think your testimony is of great interest and I would hope you would send it to our U.S. Embassies, to the Ambassadors and AID missions, so they will understand the direction in which we are now moving.

On the downside, if I might mention it, I think we have to move fast. I think we have to take sizable jumps in this new direction. Some of the figures—$10 million—I think is peanuts. I recognize there's a limit as to what you can do, that it's going to take some changes in legislation; and one of the things I would like to draw out of you in some of the questions is, what we can do to help you in drafting new legislation that will be supportive of the new direction proposed by the President and you.

It's an area that's been of long interest to me. As long as 4 years ago I wrote in the CSIS magazine that I thought we should look at the steps we are now taking.

I have a series of questions I'd like to ask you, Mr. McPherson. One is that we have to deal with the world as it is, not necessarily the way we would like it to be, and as long as our international economic competition regards foreign aid as a legitimate means to promote their economic interests I feel that we have to be willing and able to aggressively meet that competition.

As a side remark, I would hope we continue our efforts to negotiate with the OECD countries, particularly in those areas to reduce the kinds of help that they are giving, but with respect to the Third World, I don't know how practical that is.

One of my questions is, Are you undertaking studies to establish exactly what the French, Japanese, and Western Europeans are doing in tying together their foreign aid and exports generally?

Mr. McPherson. The whole area of how mixed credits fit into a foreign aid program is one to which we have been giving a great deal of thought. I, too, would hope that we can negotiate some sort of agreement within the OECD as to the extent to which countries should compete in this area because it is frequently a disservice to the Third World countries themselves and I think it is skewing the competition that we need to face. We have to face up to the fact that there is a second set of discussions we could undertake in the case of those negotiations that don't show signs of immediate success, after we evaluate where they stand. We could then discuss limiting, or determining how to limit, the various donors' foreign aid programs in connection with mixed credits. This is because what is happening around the world—and there are several countries, as you indicate, that are seriously abusing this system at this time—makes it very possible that, in the next decade, concessionary foreign aid programs are going to turn into something that has the "foreign aid" name but which takes the form of export-import banks. I think that such a development would be unfortunate.

I think there is a real need for balance of payments support for various types of projects, such as agricultural research stations and such, and I also think that it would be too bad to have such support become a type of export-import bank. As you indicate, we have really looked the other way with regard to our foreign aid program.

What do we do about that, assuming we cannot end up negotiating a broad policy agreement or negotiating something within a foreign aid program context? In such a case, well, I think we have to be ready to respond in some way. We have, first, to look at the whole U.S. Export-Import Bank role, and I am sure that in due course, if we cannot negotiate something, we have to look at our other tools. And one of the tools is foreign aid.

As you perhaps know, a few months ago, as I took over as administrator, we set up a $25 million fund within our Egypt mission that is exactly for such a purpose. This gives us more funds and flexibility to do things and it was logical that we should look at this approach. We have also looked at some other countries for the possibility of pursuing the same kind of activities.

I am, however, hesitant to pursue this approach extensively at this time, expecially beyond Egypt, pending what happens in the discussions I mentioned. Even then I am hesitant to do this too quickly or, at least, without caution because I can see that, in the end, it could adversely affect the other good programs that we currently undertake. There are, however, many things we can do if we select them carefully, and if we are conscious of the development impact of what we undertake. The fund in Egypt, for example, is not available to all U.S. exporters but, rather, the mixed credits in that fund can only be used for selected goods or products. There would be certain types of luxury items, for example, for which you would not want to use these types of AID moneys, but for equipment or programs that had a major developmental impact, you could make a better case for using this money.

It goes back to the delicate balance that you referred to a moment ago. As we build our constituency, we want to make sure we do not destroy what is unique and good about the foreign-aid program. On the other hand, we can not live in a "Pollyanna" world either. We have to be realistic. The bottom line is, yes, we are exploring this approach very carefully. To date, we have set up a $25 million program of mixed credits in Egypt and we will continue to study this approach depending, in part, on how these negotiations come along. We are very aware of what the other countries are doing and have to be prepared, I think, to be willing to respond, at least to some degree, or else we do a disservice to our interests.

Senator ROTH. Let me stress just one individual's thinking. My de facto chairman of the Finance Committee, Russell Long, often tells me, "You tell me the rules and we'll play the game," and I think that's exactly true in this area. I'm talking now about the Third World countries where I think there are tremendous opportunities. That's where almost the bulk of our exports are going. That's where I see an unmatched opportunity of doing good, of doing good both for those countries in the Third World as well as ourselves.

So I would urge you—and I believe strongly we ought to look at these other techniques being used by other countries—France and Japan. They may not be all bad, even though traditionally we have thought so. I don't think, if I may say so, you should respond, but I think we're going to have to be aggressive. Some of these major projects in Third World countries, to be both competitive and to be doable, require more than traditional aid. So that I think some of these other techniques, whatever they are called—mixed credits, parallel or mixing aid and the private sector—I think they are well worth examining because it's only in those kinds of projects where the private sector is willing to participate that probably have long-term merit.

So, I'm a strong believer that we ought to now examine what they are doing. I'm not saying copy whatever they do, but to move in a similar direction at least until we are able to negotiate some kind of an agreement otherwise.

Mr. McPHERSON. I think, in fact, that even if we are able to negotiate some things, the facts are that the foreign-aid program as it, has been traditionally implemented needs to be somewhat reoriented. As you know, we are not an international welfare agency although it is true that there are some situations where droughts, floods or other disasters cause us to move in with food and other emergency assistance and I think the American people want us to continue to do that. On the other hand, to be long-term donors of food, medicine, and such, frankly just does not bring the recipient country around and does not give it what it needs. It is trite, I suppose, but the old saying about "Don't give a person a fish; teach him how to fish" is really valid. And, to the extent possible, our programs should not be just government-to-government but should also include the U.S. Government aiding various private activities in recipient countries—such as my example of the Costa Rica bank, the only private banking institution in Costa Rica. That private banking institution appears to have the potential for having the vitality that government institutions rarely have, and there is simply a great deal that can be learned from our own experience. Therefore, we are pursuing this program approach very vigorously.

Senator ROTH. I have been notified my 10 minutes are up. We are following the 10-minute rule here. I will have some further questions, but I would at this time like to turn to Fred Richmond who participated in a study of productivity in Japan with me and I know is well acquainted with some of the things that are being done not only abroad but by businessmen here in the States.

Representative RICHMOND. Thank you, Mr. Chairman.

Good morning, Mr. McPherson. Mr. McPherson, I agree that AID ought to do a lot more with the private sector. We also understand that before we have a private sector to deal with in many of these Third World countries we have to develop a private investment infrastructure in those countries.

Now how can you account for the fact that our administration seems so negative toward America's contributions to the World Bank and other financial institutions that have been set up for precisely that purpose?

Mr. McPHERSON. Well, as you know, the administration continues to strongly support the U.S. commitments in connection with IDA VI. The administration feels that the World Bank and the regional banks indeed have an ongoing role and I believe that we will continue to be very supportive of that role.

The facts are, as you have suggested, that the World Bank, in particular, and the regional banks, to a lesser degree are very important in developing the infrastructure, the roads, dams, and so on, and I expect that we will continue to be supportive of that role.

Representative RICHMOND. But as you know, they desire to support these banks with less and less money each year in this present administration particularly. Sure, we support them, Mr. McPherson, but we want to give them less and less money each year.

Mr. McPHERSON. We have not yet determined what the administration policy should be toward IDA VII, as you know, and we are now in the process of undertaking an interagency study which is looking at bank performance and how the banks spend their money.

Representative RICHMOND. You mean the administration doesn't have a policy on the World Bank?

Mr. McPHERSON. We do not have a policy on IDA VII. Our policy toward the World Bank has been, and will continue to be, supportive. The exact levels of that support are not quite yet determined.

Representative RICHMOND. One does get the feeling that the level will be somewhat less than we have supported in the past. Wouldn't you say so?

Mr. McPHERSON. Well, I really do not want to comment on the level because that would be prejudging the interagency study, but I really want to assure you that the administration understands that infrastructure, as an example, is an important part of the development process. We understand that in this country canals, railroads, and so forth were built with government support and that was how much of the country was developed. We understand that. And we understand that the institutions we are talking about have a role in that type of development.

At the same time, we think that we do not want to burden these countries too heavily with debt. We think that projects in these countries have to be conceived on the basis of sound economics and we want to have the banks do that as well. The exact level of U.S. support and how hard or soft bank loans should be is what is in question.

Representative RICHMOND. Mr. McPherson, we all want private enterprise to get into these countries. We can take that as a blanket statement, right?

Mr. McPHERSON. I believe so, yes.

Representative RICHMOND. All of us would like to see indigenous and foreign companies going into these countries and developing them.

Mr. McPHERSON. Yes.

Representative RICHMOND. But before private enterprise would come into these countries you must have a pool of trained labor and some type of industrial infrastructure, and that, I assume, you look to these development banks to develop.

Now if our Government is going to show an indication of giving less and less money to these banks, which means less and less support, that's not exactly the message we want to broadcast to the world, is it?

Mr. McPHERSON. I think there are a couple factors to be considered here. One, as I say, we all are supportive of the banks, but the level and type of activity within the countries themselves must also be taken into account. What the World Bank does and what the other donors do is, in most countries, a small part of the overall government budget. Many countries need to make hard decisions that will be much more important than what outside help can build in the way of infrastructure. For example, many, many countries that the World Bank supports—in Africa, for example—have heavily invested in industries that eat up a tremendous portion of the budget that should be going for infrastructure. You also get so many countries with universities that have 10,000, 15,000 or even more students and, at the same time, their elementary school systems are inadequate. And this occurs because the university students have political clout. I can finally, go down sector by sector in many countries and their bureaucracies are, in effect, employers of last resort.

The World Bank is important, but the way a country manages its own budget and its own program, I would submit, is much more important than the World Bank's role. And, one of the roles that AID is playing is to facilitate a dialog in connection with this situation. I would not, however, dispute that infrastructure is important and that the World Bank is important, and we are proud both of our contribution and of the fact that we fought hard, as you know, for IDA VI.

Representative RICHMOND. I heard your remark to Senator Roth that AID feels teaching is a lot more important than giving, and I fully agree with that. Anything we can do to help develop other indigenous production of food or processing of food is better than giving it.

On the other hand, has AID any plans to use some of those enormous surpluses we have stored in Kansas City at the moment?

Mr. MCPHERSON. You are talking about enormous food surpluses?

Representative RICHMOND. Yes. We have virtually the highest surpluses of milk, cheese, and butter in our history right now. Are you folks doing anything to move some of that?

Mr. MCPHERSON. Well, the amount of food we can move depends on the amount of money that has been appropriated for food under the Public Law 480 program.

Representative RICHMOND. Have you used all your appropriations from last year?

Mr. MCPHERSON. For fiscal year 1981, yes.

Representative RICHMOND. And you have a continuing resolution——

Mr. MCPHERSON. We are on a continuing resolution now for fiscal year 1982.

Representative RICHMOND. I think you have been working on a continuous resolution for many years, haven't you?

Mr. MCPHERSON. Yes. We are no doubt, a continuing resolution agency. The primary focus of the Public Law 480 program ends up being various grains. We try to use the Public Law 480 program keeping in mind that there are four different agencies that have a type of coordinative role in it. They are State, OMB, the Department of Agriculture, and AID, and each one of these agencies have a somewhat different outlook on the program.

Representative RICHMOND. I'm wearing my agriculture hat for the moment.

Mr. MCPHERSON. Well, my primary counterpart over in Agriculture is Mr. Lodwick, a man I have known for many years and a very able person. We have sat down and said, "In the distribution of the Public Law 480 program to various countries we need to look at country "X" and decide what the United States and the country involved really ought to be getting out of the distribution of food to that country." Sometimes, instead of trying to fuse all these conflicting goals together, with nobody getting much of anything out of it, we have got to recognize from the outset that we are sending rice to country "X" because we want to develop a market for United States rice and that this decision does not necessarily have primarily a developmental aspect.

Representative RICHMOND. I'd say that's a pretty good cause.

Mr. MCPHERSON. Developing a United States rice market? It certainly is, and we ought to recognize that. But, in the past, U.S. AID has said that this was not a good cause and I don't agree with that. At the same time, in some places you really are not going to develop an agricultural market for the United States and you ought to be looking, instead, at the developmental and humanitarian concerns involved.

The key here—and I don't mean to take up too much time on Public Law 480—but the key is that, in the Public Law 480 and food programs, we have to decide, country by country what the United States goal is and whether or not we ought to be giving this amount of food or that amount of food, depending upon whether or not we can achieve our goals. Too often, Public Law 480 has been all fused together in trying to reach conflicting goals, given the money, and we have not been able to truly measure if recipients are getting anything out of it. Last year this program was $1.4 billion. That is a lot of money and is a large portion of the U.S. development budget.

Representative RICHMOND. One last question. I'm troubled by the surpluses we have in dairy products right now and I think we would be better off if we could get them out of the country. Can you suggest any particular countries where a lot of dried milk would be very helpful right now, not only helpful to the country but helpful to out own foreign relations and just in general where some special arrangements could be made?

Mr. MCPHERSON. Well, dried milk is a primary nutritional food for many people who receive it.

Representative RICHMOND. But you've got a big distribution problem.

Mr. MCPHERSON. Interestingly enough, when I was a Peace Corps volunteer in Peru in the mid-1960's, my job for part of the time was to coordinate the work of other Peace Corps volunteers who were distributing Public Law 480 food, including dried milk. There are a lot of problems with dried milk, such as women in India mixing it incorrectly and making children sick. But properly done, it can be a pretty good program. You would, therefore, want to target it where there is a real nutritional need. I can think of some places in Africa, for example.

Representative RICHMOND. Then you've got the distribution problem.

Mr. MCPHERSON. Well, usually schools work well for distribution. The fact is, though, that you have an overall limitation on the amount appropriated for Public Law 480 and, I think, given the amount that the President has asked for, and the budget restraints, it will not be easy. Public Law 480, like everything else, is constrained, but we are able to do a decent job. We are aware that one of the factors in deciding how much food of what type to distribute is the amount of U.S. surpluses in those various commodities. So, with a high amount of surplus milk, that is obviously a consideration—a consideration, I might add, that the Department of Agriculture does a very good job of bringing up in our interagency discussions.

Representative RICHMOND. Thank you.

Senator ROTH. In your answers to Mr. Richmond, I think you pointed out there are something like four different agencies involved in Public Law 480. I might say that as chairman of the Senate Government Relations Committee I have been very much concerned about the organization of both aid and trade. Now it's my understanding that in the 1982 Foreign Assistance Act, as reported out of the Foreign Relations Committee, it's been alleged IDCA has not performed coordinating functions it was set up to perform. Yet it does seem to me that we have to have some kind of vehicle here, just like we do in trade, to coordinate these efforts. So if IDCA is to go, do you have any suggestions as to what might be a substitute?

Mr. MCPHERSON. Well, the Senate Foreign Relations Committee reported out as you indicated, but I believe the House Committee takes the opposite view and that the whole matter is in the process of being considered by the administration. I believe it is fair to say that the view around town is that some sort of coordination needs to be done. We have not yet worked out what the best mechanism would be.

I would like to add that, insofar as IDCA, since at this time I wear both the AID and the IDCA hat, to avoid the bureaucracy and second layer that it was in the process of becoming, I have reduced much of its staff. I am a little bit constrained here because, within the administration, we are still talking about how we should respond to the generally recognized need for coordination while avoiding any excessive bureaucracy. It is clear, regardless, that it is important for me, as AID Administrator, to be able to communicate and work closely with with those other groups that have an impact upon us and we upon them.

Senator ROTH. Well, I feel very strongly that there has to be somewhere in government someone responsible for the aid policy, just as there should be with respect to trade. It may be that IDCA should go and we haven't raised any jurisdictional questions, but it is something we will be following with great interest.

Mr. MCPHERSON. Yes. You perhaps recall that you and I discussed this on the phone.

Senator ROTH. That's correct, and we want to continue to do so.

Mr. MCPHERSON. Excellent. I'd like to do that.

Senator ROTH. Because with a move in a new direction it's particularly important that everybody follow that direction and not try to go off on their own, which has been a problem in the past.

Mr. MCPHERSON. Yes.

Senator ROTH. One complaint we get from business in the area of AID is the lack of flexibility by AID missions in the field, in contrast, for example, to the Economic Support Fund that's controlled by the Ambassador. Are you giving any consideration to providing that kind of flexibility to the field?

Mr. McPHERSON. A great deal, Senator. I should note that while we work closely with the Ambassadors, the Economic Support Fund is controlled by the AID mission directors. A few weeks ago I signed a number of orders which gave our missions a great deal more authority. For example, we have given them more authority to amend contracts and to sign obligations for larger amounts of money. There are a number of other ways in which we are in the process of giving the field a lot more authority. I mentioned the new Bureau for Private Enterprise having some oversight over private enterprise projects, but I have been very careful to insure that the Bureau for Private Enterprise did not have the authority to block project design and implementation details. I do not believe that this Bureau should have the authority to block project design and implementation details. I do not believe that this Bureau should have the authority to administer the private enterprise projects after they are in place and I feel strongly about that.

There is another thing that is, frankly, kind of basic. We have been directed by OMB to reduce staff by substantial numbers, and virtually all these cuts have come out of Washington. My experience, having lived in this town for a long time, is that when a bureaucracy finds people, it finds a reason to exist and it is important, therefore, that cuts be made in Washington if I really want the Washington role in our operations to decrease.

Senator ROTH. They say that's even true of congressional staff.

Mr. McPHERSON. Your staff is looking back and forth. I am sure that cannot be so.

Senator ROTH. In trying to develop economic development programs and objectives, it seems to me that it's particularly important that you not only work with business and management but that we try to bring labor into the picture. I wonder if you have had a chance yet or intend to or are doing anything in furthering the role of American labor?

Mr. McPHERSON. Well, as you probably know, the AFL–CIO has a fairly substantial contract with AID in Latin America. My recollection is that, for fiscal year 1981, it amounted to something like $8 million. And there is a comparable entity, AAFLI, working in Africa and Asia. Both are important projects on which to work closely. We need to have a free labor movement in these countries and there needs to be some recognition of the role they can play in a private enterprise environment. I cannot tell you that we have done a great deal of work there yet, since more needs to be done.

Senator ROTH. As we develop new policies of bringing the private sector in, I think it's extraordinarily important that we try to work with labor and get their support in these endeavors.

Mr. McPHERSON. I believe this goes to the whole constituency building you mentioned, too.

Senator ROTH. That's correct. Some people believe that the countries should be graduated from U.S. aid programs when they reach a certain level of development. Others assert that that would just open the door for the competition to carve out market shares. For example, there have been a number of studies or papers that show that the French and the Japanese are moving in, in a very large fashion in such countries as Brazil, which is one of the certainly exciting growth nations of the world. By continuing to use a mixture of aid and private sector, they are able to get in on the ground floor on large projects. Their participation is important to the immediate situation and also the long term shows that they will have a better avenue to exports into that country. Have we given any thought to that kind of a problem?

Mr. McPherson. Our trade and development program, which is not large, is one of the relatively few tools we have to deal with this question. It does have the authority to do, and indeed does do, some feasibility projects in countries such as Brazil. Of course, the other tool we have is the Export-Import Bank, but it treats Brazil like it does France, for all practical purposes. While I am not sure of the details, I believe that to be true. And we are worried about this insofar as "middle income"countries such as Brazil.

Senator Roth. You call them what?

Mr. McPherson. We call them "middle income" countries. It is a matter beyond TDP's ability to compete against the enormous resources others are investing. This involves, rather, the whole question of Export-Import Bank negotiations on mixed credit. At this time, besides the TDP and Ex-Im Bank and like programs, I do not think we have the authority, and I am quite sure we do not have the money, to compete. In this area, given the budget constraints, I suppose it is just going to be hard to do that. It certainly is a problem, however.

Senator Roth. I think it's a very critical problem that you ought to closely study and determine how we can meet the challenge in these other countries.

Mr. McPherson. The other program we have—and you are going to be hearing from Mr. Nalen shortly—is the Overseas Private Investment Corporation which has limited guarantee authority.

Senator Roth. You see my concern is that other countries are moving very heavily in these areas. France is spending something like $2 billion to promote exports and foreign developments to help its trade. Japan is using all kinds of techniques and being extraordinarily successful.

Mr. McPherson. Absolutely.

Senator Roth. CSIS recently published a paper that said the failure of the U.S. Government to fight for its industrial markets is resulting in major long-term losses. The aid budget of our competitor governments is an important weapon in this war. It goes on to say, "If the United States wishes to participate significantly in the Third World markets, where the majority of future economic growth is to take place"—I think that's extraordinarily important to understand—37 or 38 percent of our exports now go to the Third World and we underestimate their importance—"that we must develop an industrial policy similar to the agricultural policy." I would point out in the export of farm products we do a far better job than we do industrially and I think we can use that as an example.

Mr. McPherson. Yes. That is a very good point. We have for years seen the need to develop an export market and, of course, look at what a problem our oil import bill would be if we did not have our agricultural exports.

Senator ROTH. Again, I want to stress that I'm very strongly supportive of our efforts to negotiate with the other major industrial nations a set of rules that govern not only our relationship with the OECD nations but the Third World as well, but as I said earlier, I think we have to meet the competition. I realize when you start talking about aid programs and mixed-and-parallel financing practices that you tend to be opening, as this article says, a Pandora's box. To whom should the aid be given? What kind of aid is appropriate? What terms are appropriate? When a parallel credit is given, is it unfair competition or legitimate aid to maximize the resources put into a particular country?

It's these kind of questions that I think have to be addressed as we move toward this new policy. And I do want to congratulate you for the efforts you're making. I think they are critically important. I think we have to move expeditiously.

I would like to ask, Mr. McPherson, if we hold hearings if we ought to do them periodically? I don't want to take too much of your time, but I would like to invite you to come back perhaps next spring to review where we are then.

Mr. MCPHERSON. I wonder in the meantime, Senator—I know of your longtime interest in Japan and I know you have really become a student of their economic policies. I wonder if perhaps, not here but privately sometime we might pursue that at greater length?

Senator ROTH. I would be very happy to, both my staff and myself, to work with you. Thank you very much for being here today.

Our next witness is Mr. Craig Nalen, who is president of the Overseas Private Investment Corporation. Mr. Nalen, welcome. You're in some ways president or head of what might be called a prototype of the kind of organization that brings together a cooperative relationship that not only serves to promote economic growth in the Third World but also produces substantial tangible benefits for the U.S. economy. I might underscore that OPIC also has the great virtue of paying its own way. I was very pleased that the Senate overwhelmingly cast its vote for extension of your appropriations operating authority. We look forward to hearing your comments.

Again, the rule is that if you can summarize your remarks, then we will include the full prepared statement in the record.

STATEMENT OF CRAIG A. NALEN, PRESIDENT, OVERSEAS PRIVATE INVESTMENT CORP.

Mr. NALEN. Thank you very much. As an aside, I'm sorry that I can point to no constituents of yours on my staff. However, they are all very loyal admirers of your subcommittee and what you're doing.

I would also like to make an aside that I cannot give expert testimony on the activities of bureaucratic agencies, mostly because I'm relatively new on the scene and frankly I do not understand them at all.

Senator ROTH. You're not alone in that regard.

Mr. NALEN. I do think, having been a businessman and involved in the private sector for almost 25 years, the last 5 of which have been chairman and chief executive officer of a public company, that I can give some valuable insights on how the private sector views the activities that we're going to talk about today.

I'd like to thank you very much for giving me this opportunity and also to point out that we do have a brief statement which we have submitted.

I am delighted to be given the opportunity to talk and answer the question, Aid and the private sector: can they work together? At the Overseas Private Investment Corporation you will find that the answer to that question is a resounding "Yes." As President of OPIC and given the question on whether the public and private sector work together, I feel a little bit like Ulysses S. Grant who went unrecognized and was asked, "And what did you do during the war, sir?" You see, your question allows me to describe on behalf of my agency the successes and hopes of a long campaign.

During OPIC's 10 years of existence this agency has proved that a program sponsored by the U.S. Government can further U.S. foreign policy and assistance goals while at the same time provide an invaluable service to American businesses. OPIC is, in fact, a model of how the U.S. Government program can form a partnership with U.S. businesses to achieve mutually beneficial objectives. At a time when congressional aid is being reduced; at a time when U.S. businesses are struggling with competitors from other industrialized countries to capture a place in world markets; at a time when those foreign competitors get strong backing from their governments; there has never been a greater need to forge a closer relationship between business and government. There has never been a greater need for OPIC.

Senator Javits is largely responsible for the idea that there should be a separate U.S. Government entity, operated as a business, by people experienced in the private sector, to work with and encourage American companies to invest in developing countries and thereby contribute to achievement of U.S. foreign assistance and trade policies. As a result of legislation he and others in Congress sponsored, OPIC was set up as a separate agency more than 10 years ago and told to operate on a self-sustaining basis without annual congressional appropriations. OPIC's record has shown that the Congress and Senator Javits were right.

For over a decade, OPIC has facilitated billions of dollars of private investment in developing countries which, in turn, has resulted in billions of dollars of U.S. exports. Let me give you an example of some of our recent success. During fiscal years 1978 to 1980, OPIC investment incentives went to projects valued at about $4 billion, of which U.S. investment was $1.7 billion. Over the first 5 years of operation, these projects are expected to utilize $3 billion in U.S. goods and services. In addition, millions of dollars will be returned to the United States as dividends and interest payments. Moreover, every project assisted by OPIC has met the strict standard set by Congress that OPIC only assist projects that are developmental and beneficial to the host country and its people. In addition, OPIC projects make a significant contribution to U.S. economic growth and trade competitiveness. So you can see why I believe that the private sector and U.S. foreign assistance can work together. And, I see an even greater need for this type of cooperation in the future.

As the availability of concessional aid becomes scarce, nations of the developing world are increasingly turning to direct foreign private investment to create the jobs, generate the tax revenues, manufacture the goods needed both for domestic use and export, and provide the necessary training in new skills and techniques necessary to improve the hope for a better quality life. It is in this rapidly changing economic context that OPIC's programs become so important, for in facilitating and encouraging U.S. private investment abroad, OPIC adds an essential dimension to the U.S. foreign assistance effort and is a vital complement to our bilateral assistance efforts.

OPIC has a unique, and increasingly important, role to play in the foreign assistance effort. By encouraging both large and small American businesses in their foreign investment activities, as well as assisting cooperatives and private voluntary organizations in initiating or expanding oversea enterprises, OPIC harnesses the initiative and vigor of free private enterprise to resolving the most urgent problems of the LDC's: increasing employment, developing local sources of energy, and improving agricultural productivity, and expanding export capacity. Thus, both OPIC and private foreign investment are particularly attractive mechanisms for complementing and supplementing concessional assistance to the developing nations.

OPIC is committed to the belief that private investment must be the lead element in overall U.S. development policy for two reasons.

First, private investment means a long-term commitment to a commercially viable project. Whether it is a large company which commits itself to a multimillion-dollar project or a smaller company committed to a smaller investment, these companies are there for the long haul. And I emphasize the word "commitment." These companies are not there merely to pave a road or dam a river; rather, their investment represents a long-term commitment to operate a viable, profitable venture, capture and develop a market, insure a satisfactory return on investment and provide a stronger base upon which its international operations may operate in the future.

The second reason private investment should be a central element of U.S. foreign assistance is that it encourages reliance on free enterprise. We all recognize that our own Nation has become strong and great largely as a consequence of our free enterprise system. We think that the economic discipline imposed by the marketplace has helped us to make sound decisions about the allocation of our resources and the achievement of our national economic objectives. President Reagan recently referred to this when he spoke of the "magic of the marketplace" and said that the key to economic advancement was to "reward longer toil and legitimate risk." As we know, this can only be done through a free enterprise system.

Promoting U.S. investment in developing countries will also move this country toward meeting the critical goal of a strong, competitive U.S. trade posture. The health of the United States economy, more than ever before, is determined by our ability to trade in international markets, particularly the emerging, fast-growing markets of the developing countries. Developing countries now buy nearly 40 percent of our manufactured exports, and non-OPEC developing countries are our fastest growing export markets. But competition for these markets is keen—the U.S. share of manufactured exports from industrialized countries to the developing world slipped from 28.8 percent in 1979 to 26.1 percent in 1980. Only through aggressive efforts will we be able to maintain and improve our position in exporting to the Third World. This is a disheartening and discouraging trend which must be helped. Promotion of U.S. direct investment in the developing world can help meet this challenge; exports follow close on the heels of direct investment abroad. If we fail to take advantage of the opportunities for creative and profitable investment, our competitors from the other industrialized countries will be eager to seize them. This competition is especially keen in the upper income developing countries where there are burgeoning markets for imported industrial and agricultural products and systems. Investment in those markets by U.S. companies can assure access to those markets. OPIC activities in promoting U.S. investment thus also make an important contribution to a strong U.S. trade position.

The opportunities in the developing world are great, but so are the perceived risks; no U.S. business, large or small, can consider an oversea investment without considering the political risk factor. Iran, Afghanistan, Nicaragua, and El Salvador are recent reminders that no developing country, not even a relatively economically advanced one, is free from major internal disruptions which adversely affect foreign investment. In short, real or perceived political volatility, economic uncertainties, and currencies whose value may fluctuate widely constitute disincentives which may cause deferral or cancellation of foreign investment plans. One way to alleviate the problem is an investment incentive program that will protect against some of the key political risks and make available some long-term assistance to prospective investors where this vital investment component is otherwise unavailable. This is the basic need that OPIC serves.

In recognition of the value of such programs, 18 other industrialized countries have instituted investment incentive programs similar to that of the United States. They are designed to facilitate investment by their national companies in LDC's. Virtually all of these programs, unlike OPIC, are subsidized by their governments and none are required to operate on a self-sustaining basis with due regard for prudent risk principles, as is OPIC. Foreign competitors of U.S. business are assisted and aggressively promoted by their governments. Such assistance has certainly been a factor in heating up the competition overseas and in contributing to the sad result that America's share of the rapidly growing Third World market has been shrinking.

The private U.S. insurance market is unable to provide U.S. business with the backup needed to meet this competition. While a few private insurance companies offer very limited political risk coverage, they only write short term policies—1 to 2 years—often at rates far higher than OPIC's, and do not protect against some of the primary political risks—loss due to war, revolution, insurrection, or civil strife. In addition, these private insurers do not have the financial capacity to meet the needs for coverage which U.S. industry must have. Unless the U.S. Government, therefore, continues to make available adequate incentives through a program such as OPIC, this country's investors could well find themselves at a disadvantage in the race for a larger share of developing country markets and for access to assured source of minerals and energy supplies.

Mr. Chairman, I said earlier that OPIC had proved that a U.S. Government agency could work successfully with the private sector to achieve U.S. foreign assistance goals. I also said that there would be an even greater need for our services in the future. Let me briefly tell the subcommittee of some of the actions OPIC has recently taken to meet this need.

First, we have reorganized our two operating departments, insurance and finance, in order to be more responsive to American businessmen. Henceforth, our staff will be encouraged to develop greater expertise in particular industries. For example, one office will focus upon encouraging hydrocarbon exploration projects, another on agribusiness projects. We also will have an office that will be specifically charged with the responsibility of developing new OPIC services to facilitate investments by American businesses.

Second, we shall aggressively market OPIC's services to both large and small U.S. business. We will be targeting specific industries where there are significant opportunities for U.S. investors in the developing countries—industries such as fisheries, construction, and agriculture. We shall be redoubling our efforts to bring specific investment opportunities to the attention of U.S. businesses.

As an example of the type of effort we intend to make to reach and inform relevant U.S. businesses of opportunities in developing countries, I would like to specifically note a series of industry-specific seminars on oversea investment opportunities that OPIC has inaugurated. Just a few weeks ago OPIC sponsored a seminar entitled "Overseas Investment in Construction Materials and Equipment Manufacturing" that attracted 150 businessmen from 102 U.S. firms. More than 70 of these firms were small businesses. They heard representatives from Brazil, Egypt, Indonesia, Nigeria, and Saudi Arabia outline the opportunities available in this sector of their countries, representatives of OPIC explained our services, and experienced international bankers and businessmen, such as Winton "Red" Blount, discussed some of the benefits and the liabilities of operating in developing countries.

Pursuant to congressional directives, OPIC will make special efforts to reach and assist small businesses to take advantage of investment opportunities in developing countries. Smaller businesses are particularly well suited to take advantage of investment opportunities in the smaller developing countries which are often passed over by large multinational firms.

Third, we are exploring ways to strengthen OPIC's insurance program for contractor's and exporter's bid, performance and advance payment guaranties. OPIC strongly believes that it is in the national interest to facilitate the winning of construction and supply contracts in developing countries by U.S. contractors and exporters.

Finally, we shall direct special attention to those geographic areas where there is a confluence of U.S. national interests, developing country needs and comparative advantages to U.S. businesses. The best illustration of such an area is the Caribbean—our own backyard. We have been and will continue to be very active in this region. The overwhelming majority of our direct loans to U.S. small businesses in the past 3 years were in the Caribbean, as was almost a quarter of our insurance activity in the past year. I, and other key members of the Overseas Private Investment Corporation, will personally be leading two OPIC-sponsored investment missions to Jamaica and Haiti in the next 2 months.

In short, Mr. Chairman, I am bullish in this bearish world about the role that private American investment can play in the developing countries, about the U.S. Government role in general and OPIC's role in particular in facilitating that investment, and about the trade and employment benefits that will accrue to the United States from such investments. There will, of course, always be development needs that cannot be served by the private sector: needs that must necessarily be served by concessional aid and aid through official bilateral and multilateral assistance channels. However, the role that the private sector can play in the development process has for too long been underestimated and underutilized.

The needs of the developing countries for additional resources to sustain their growth will grow considerably in this decade. However, substantial increases in concessional aid from industrial countries cannot be realistically expected. The private sectors of the United States and the developing countries must, of necessity, be relied upon to generate the economic growth that is needed to sustain the development process.

In short, Mr. Chairman, aid and the private sector can work together. They must. And with enlightened U.S. policies, they can do even more. You have asked if the Government and the private sector can work together to achieve common goals. Well, if the programs of the Overseas Private Investment Corporation over the past years and the achievements of that agency over the 10-year span are any indication, the answer to your question is a resounding yes. Thank you, sir.

Senator Roth. Thank you, Mr. Nalen. I agree with you that OPIC has been a model of how there can be a partnership between government and business and I think it's testimony to the foresight of Senator Javits in providing a real development in this approach.

You mentioned in your statement that there were 18 other industrialized countries that have investment incentive programs similar to ours. They are not expected to be self-supporting as you are, and I congratulate you and hope you continue to be so. But I wonder if you could give us a little more detail about those programs. How do they compare in size, scope, coverage? How do they relate to those country's export financing facilities? Are they integrated into their aid programs or are they treated as part of the foreign commerce activity?

Mr. NALEN. In almost every case, they are very closely associated with their government policy and programs and essentially, to the best of our knowledge, they are closely integrated with other elements of the development process. However, I should add that in no case do we know of any OPIC type of investment insurance program that have been any more effective or any more successful than our own. To be sure, there are other elements of assistance programs, primarily in the Eximbank which is out of my priorities or responsibility, which are much more aggressive and helpful. Their insurance programs are similar to ours. Their premiums are somewhat higher—excuse me—ours are much higher. Theirs are quite a bit lower, a bigger break for their private sector. But, by and large, we feel that the programs that we are dealing with basically are good enough to get the job done here.

And I might comment, as has been reflected in what we have just observed in the last quarter of our fiscal year which just ended, that during a 3-month period we did more business than we did in the full years of 1978, 1979, and 1980, and the carryover of business applications and business into this new fiscal year, would seem to indicate that this current year is going to be significantly higher than the record year just completed. I'm not sure what conclusions you draw from that except that the American business community perhaps is convinced that what President Reagan may have been saying 15 months ago and then again last November and again this spring and during the summer consistently—that there will be a greater role to be played by the private sector in our foreign investment program—they are believing that. They are convinced that these oversea markets are indeed the markets that they must aggressively pursue and it is a heartening sign in this bleak economic environment that we do see some growth here.

Senator ROTH. I was greatly concerned several years ago when I went to the Mideast and learned that we were not doing too well in international competition in the construction business. I wonder, do you have any programs specifically designed for the construction industry?

Mr. NALEN. Well, as a matter of fact, we have one program of a letter of credit for contractor's insurance program but the real teeth of our construction program that we had aimed at that industry is no longer part of OPIC's overall program. Interestingly enough, this very same question was asked of me last week when I participated in a panel with an industry association gathering of the constuction and engineering industry. Apparently, several years ago, what used to be part of the OPIC program was taken out primarily because we had certain restrictions on the countries—the per capita gross national product definition restricted us to a broader area of operation. However, that's been removed and I would think now, based on the interest from the industry itself, that the time may be right to reexamine that program and it ought to be integrated back with ours because it is a logical spot for it.

Senator ROTH. Let me ask you this further question then. Are you saying that, in your judgment, it should be part of OPIC?

Mr. NALEN. Yes, sir; I say that, and with your support I think we will undertake a program to retrieve that particular program.

Senator ROTH. Representative Richmond.

Representative RICHMOND. Thank you, Mr. Chairman.

Mr. Nalen, with worldwide interest rates as high as they are, are you finding any reduction in American companies' willingness to make substantial foreign investments?

Mr. NALEN. Well, on the contrary, and that is the surprising finding from the statistics which I just mentioned that we have noticed over the last 3 or 4 months in really breaking up of the logjam of applications for insurance to cover projects overseas. Suddenly they are springing forth, which is surprising in the light of tough interest rates and a tough economic climate, and we would attribute that I think to a number of things, one of which is the more aggressive stance that we at the Overseas Private Investment Corporation have been taking and an outreach program to encourage more investment, but primarily I think it is the United States business community's recognition that they no longer can keep looking at the domestic economy for expansion and creation of new jobs. They must become more aggressive in the world marketplace. So the answer to your question is we see an acceleration in interest in overseas investment.

Representative RICHMOND. How does your volume in the first 6 months in your tenure compare to the prior 6 months, volume of loans?

Mr. NALEN. Volume of loans—well, I came into the agency—although I'd like to attribute the surge to my personal presence, I can't really do so mostly because some of my people are sitting here and know better. I came aboard for really the last 3 months of our fiscal year which ended September 30, and the amount of business came in those 3 months—we did a little over 60 percent of the year's business in those 3 months—and that incidentally gave us for fiscal 1981 a record year in the amount of insurance written ever by the agency, and as I say, in 1982 we will significantly top that.

Representative RICHMOND. So it is growing?

Mr. NALEN. Sir?

Representative RICHMOND. So it is growing? OPIC is growing?

Mr. NALEN. Growing, yes.

Representative RICHMOND. You mentioned a possible direct loan program to the Caribbean. I understood that the administration was somewhat against direct loan programs to the Caribbean. Is that change of administration policy or what?

Mr. NALEN. Well, I don't know if I'm the best person to comment on the administration's policy. I will say that as the President of OPIC we were surprised at first—there seemed to be some confusion as to whether there was full support for a direct loan program inasmuch as the direct loan program was aimed almost primarily at small businesses and almost all of those projects were aimed at the Caribbean. I think a bill that has finally been signed, I was told—that bill was signed late Friday afternoon—does not exclude us from undertaking a program of direct loans. So we feel good about that.

Representative RICHMOND. How do you find OPIC in competition with, for example, Japanese companies? Do they have many, many other or more areas of subsidization than our American companies?

Mr. NALEN. Well, the Japanese accomplishments worldwide are well known and I think Japan has certainly captured a lot of publicity in terms of their accomplishments, no question about it; and we do see Japanese companies and we see German and French companies—however, I will say that, contrary to public opinion, the United States is still looked to as the leader in technology and engineering expertise and I think it's more a question, if I may make a comment, of a mental attitude and one of determination and recapturing the reputation of the old Yankee trader that will put us back where we belong and, frankly, that's where we're going I think, and with expansion of those programs we're undertaking I think we can certainly get to that position.

Representative RICHMOND. I think we agree, Mr. Nalen, that the American businessman and the American public in general have a feeling that foreign governments subsidize their own businesses much more than we do here. I suppose that is true overall?

Mr. NALEN. Yes, sir.

Representative RICHMOND. OPIC is a good example of what we are doing to further foreign trade.

Mr. NALEN. Yes, sir; I would say so without any question. We are great proponents of the free enterprise system and keeping the government off the backs of business. I think this is not a paradox really. I think in a domestic economy that's necessary. However, when you're dealing in a domestic economy you're dealing with familiar unknowns and business can cope with that and should be allowed to operate in a free marketplace. However, when you're dealing in the international marketplace and some of the hazards are not familiar ones—you can predict with some accuracy the fall of prices, for instance, but you cannot predict the fall of governments. This is where this country and its government must work closely with the private sector and particularly in light of the extraordinary tough foreign competition we are getting in these areas.

Representative RICHMOND. What's the name of the agency in Japan that would parallel yours? Would it be the MITI?

Mr. NALEN. Yes, sir.

Representative RICHMOND. The Ministry of International Trade in Japan can do the same direct loan and insurance operation that OPIC does?

Mr. NALEN. Yes, and with much greater latitude I might say, on that subject, than our direct loans and our loan guarantees. We have limits imposed on us and therefore tougher limits each year which is puzzling.

Representative RICHMOND. Is MITI's volume for this area much larger than ours?

Mr. NALEN. Rather than giving you an answer I'm not sure about, I would like to return with a written response to you.

Representative RICHMOND. Will you, please? I would be very much interested in your comparing OPIC to that division in MITI which handles a similar operation.

Mr. NALEN. Yes, sir. My guess is that it is considerably greater, but I would like to confirm that.

Representative RICHMOND. Perhaps if you could take it up to 3 years I would appreciate that.

Mr. NALEN. Yes, sir.

Representative RICHMOND. Thank you very much. Thank you, Mr. Chairman.

Senator ROTH. Thank you.

Mr. NALEN. Mr. Chairman, if I might just say one thing here, I would like to state something for the record. It was just brought to my attention on Friday afternoon that an organization here in Washington called the International Management and Development Institute asked several hundred representatives from business and from parts of the Government questions relating to proposals for U.S. Government and business action related to the same subject we are talking about today, working closely with the private sector and encouraging overseas private development, and they had 10 proposals which included expanding the Ex-Im Bank loan authorization, centralized trade in the Commerce Department, and one of the questions was a proposal to expand the Overseas Private Investment Corporation. And I think it's a matter of some interest that in ranking those proposals, the expansion of the Overseas Private Investment Corporation was the No. 1 ranked proposal, which perhaps reflects the feeling from many segments of the private sector as to the role this agency has played and can continue to play in the future.

Senator ROTH. I thank you very much for your testimony today, Mr. Nalen, and wish you well in your new efforts.

Mr. NALEN. Thank you, Mr. Chairman.

Senator ROTH. At this time I'm pleased to welcome the State Department Assistant Secretary, Bob Hormats. Bob is not new to the Washington scene. I read in the press reports that he's a rising star. He's certainly been a most articulate, thoughtful, economic policymaker in several administrations. We are most fortunate to have him here with us today to give us some idea of how the administration is viewing the private sector orientation to AID programs as it relates to continuing demands from the Third World for massive resource transfers from the industrialized West.

Mr. Secretary, you probably are familiar with the rules and you can read your statement or if you choose to summarize, it will be included in the record.

STATEMENT OF HON. ROBERT D. HORMATS, ASSISTANT SECRETARY OF STATE FOR ECONOMIC AND BUSINESS AFFAIRS

Mr. HORMATS. Thank you, Mr. Chairman. I will spare you a full reading of the prepared statement and just go over some of my thoughts on the subject.

First, I'm quite convinced, and I believe most people in the private sector are as well, that there is an opportunity for an increased role, for the U.S. private sector in the development process, a role which can enhance development and can in fact contribute to the profits and market expansion of the private sector itself. The private sector has demonstrated a remarkable contribution to the development process in a number of countries—Korea, Singapore, Brazil, and a number of others—which have gone out of their way to develop an investment climate conductive to the private sector and in effect harness the dynamics of the private sector and in so doing benefit both their economics and their export programs.

Over the next several years, one of the interesting phenomena in the world today is going to be the increased competition for capital. The competition will be the result of a number of factors: first, including the high level of pent-up investment demand; and second, the fact that in a number of developing countries there is a good deal of risk attached to development. Therefore developing countries, in order to overcome that risk or to get into the game of attracting capital, are going out of their way to attract capital with such things as subsidies or incentives for private investment.

This is an interesting contrast with 10 years ago; 10 or 15 years ago, many countries had a rather porcupinish attitude toward foreign investment. Today, they are beginning to realize that with aid not increasing very rapidly, and with the need to develop new jobs and attract technology, investment is going to be important; a number of these countries are going to compete for it.

Over the last several years investment from the developed to the underdeveloped countries has gone up rather dramatically. From 1973 to 1978, it went up by about 19 percent, up 10 percent from the previous 5-year period. A large number of developing countries have gotten a very small share of that overall investment pie. The reasons are quite obvious: First, they do not have as good an investment climate as some of the other countries: second, they tend to change their investment rules from time to time and generally their image on the world's investment scene is not very good.

One of the problems this poses for us is that a lot of the investment which might have taken place in the mining sector, for instance, simply is not going into that sector because: First it's very expensive; second, there are very long leadtimes; and third, the risk is high. If you get into these very long leadtime investments and the investment climate is very poor in the country, you run a risk. Accordingly, overall investment in the mining sector in many of these countries has remained relatively stagnant over the past several years.

The harm in this is that when the economy does turn up, as we expect it will, there's going to be a very sharp increase in the price of raw materials largely related to these low levels of investment in the past.

The United States is going to be working very closely with the developing countries to try to develop ways of dealing with the overall investment problem.

As you know, we have improved treatment of foreign source personal income through legislation passed by the Congress; and that should help remove an obstacle to the operation of some of our companies abroad. OPIC has done an understanding job in promoting investment and under its current leadership has become very, very active in this area. It was active before, but there's a new dynamism that I think is very helpful and is appreciated very much by the private sector. In addition to that, changes are underway to better define the extent and scope of the Foreign Corrupt Practices

Act. It is clear that business is unfairly burdened by the present legislation. Clarification of this act will be particularly helpful to a number of American companies.

Also export trading companies, though not directly related to investment, are helpful in getting smaller American firms into the exporting game.

The trade and development program in AID is, in my judgment, one of the most unsung and best programs the United States has today. Unfortunately it was funded at very low levels in the past. The program provides seed money for doing preinvestment surveys. It brings American technicians overseas and they normally will develop projects and, working with the host government, provide specifications which American firms are most likely to take advantage of. That program has an enormous multiplier effect. Almost every other country in the world gives large grants for seed money for investments; we put in $4 or $5 million. It's pitifully small compared to the enormous investment and trade benefits which follow on.

We are also trying to negotiate bilateral investment treaties with developing countries, without overwhelming success, but we are still trying. I wouldn't want to hold my breath for the day we can do it, but it's still, in my judgment, a very important thing to do. Other countries have them, with more limited objectives than ours.

The multilateral banks are particularly important in the area of investment and we have been encouraging the World Bank to do more confinancing. In other words, put a smaller share of its money in with money from U.S. banks to give it a multiplier effect. The International Finance Corporation can play a very key role in the investment area. It's strongly supported by the United States and we hope it will play a more aggressive role in the future.

World Bank President Clausen has recently proposed an idea of a multilateral insurance agency under the aegis of the World Bank. In my judgment, this is well worth a considerable amount of study. I think it has great potential for a number of reasons: (1) Because it helps our own OPIC and the other 18 OPIC's pool risks; (2) because it can be very helpful for the OPEC countries, it will induce a greater amount of OPEC money into the developing countries. This is something that is particularly useful and something we ought to consider.

Let me just touch on a few other things. We recently have been working very closely with a number of American business people to discuss what they can do without the Government to play a greater role in the developing world. We have heard of a number of very innovative ideas which the private sector has done totally without the Government. In one case, in the agricultural area, a major American university has been working with Nigeria to send Nigerians to the United States, where they work on farms and learn about American farming Techniques. When they go back, they are acquainted with American techniques, American technology, American fertilizers. It's a very profitable follow-on.

A number of other firms are trying more and more to provide consultants to developing countries' firms so the firms become acquainted with the products that the United States makes. There's a lot of follow-on there.

There are several other programs which I touch on in my prepared statement. One other area that's particularly important are the U.S. business councils with the developing countries; I believe this is noted in the statement by the chamber. We have a business council with Sudan, Nigeria and the United States have a business council and a government-to-government consultation arrangement. There are a number of other relationships of this nature. These are extremely important because they put our economic relations in a broader framework and enable us to pull together the work of Exim, OPIC, and all the various types of aid. We can take a look at what programs we have and discuss them with the other countries, and tailor the approach in such a way that it's conducive to the needs of that country and to our own bilateral interests

In closing I think it's particularly important that we in the State Department continue and enhance the close cooperation we have had with the U.S. business community, both to insure full support for their efforts as investors and exporters and to give them the sort of information they need before they make decisions about trade and investment in the developing countries.

One of the very interesting new ideas around the world is political risk insurance. Lots of firms are now hiring consultants to describe and discuss political risks. The State Department may not be in the insurance business, but there are lots of opportunities for American firms and for the State Department to discuss together the outlook for a particular country, to help the American firm in its investment decisions and, by the same token, for us to learn more about the investment climate in particular countries by getting advice and information from the private sector. These relationships are particularly important to the future when we face an uncertain investment climate. Thank you, Mr Chairman.

[The prepared statement of Mr. Hormats follows:]

Prepared Statement of Hon. Robert D. Hormats

I AM A STRONG BELIEVER THAT THE ADMINISTRATION'S PRIVATE SECTOR EMPHASIS IN OUR POLICIES TOWARD THE DEVELOPING WORLD CAN BE OF CLEAR BENEFIT BOTH TO THEIR ECONOMIC INTERESTS AND TO OURS. A KEY ELEMENT OF AMERICAN POTENTIAL IN THE WORLD IS THE POWER OF THE U.S. PRIVATE SECTOR TO STIMULATE AND REINFORCE ECONOMIC GROWTH ABROAD. BUSINESS INVOLVEMENT NOT ONLY SUPPLEMENTS BUT FAR SURPASSES OUR OFFICIAL AID ACTIVITIES AND CAN GO A LONG WAY TO MEETING THE CONTINUING THIRD WORLD NEED FOR CAPITAL AND TECHNOLOGY FROM THE WEST.

I KNOW THERE HAS BEEN SOME SKEPTICISM ABOUT THIS PRIVATE SECTOR EMPHASIS, BOTH ABROAD AND IN CERTAIN CIRCLES IN THE U.S. BUT I, FOR ONE, REMAIN CONVINCED THAT THE DYNAMISM, COMPETENCE AND RESOURCES OF AMERICAN BUSINESS CAN AND SHOULD BE MORE FULLY ENGAGED IN THE DEVELOPING WORLD.

TO LEARN HOW THIS POTENTIAL CAN BE MORE EFFECTIVELY ENLISTED AND TO SEE HOW OUR GOVERNMENT CAN FACILITATE THESE EFFORTS, WE HAVE CONDUCTED AN INFORMAL DIALOGUE WITH A WIDE VARIETY OF BUSINESS LEADERS IN THE PAST SEVERAL MONTHS. WE HAVE LEARNED MUCH AND HAVE COME AWAY ENCOURAGED.

THE AMERICAN PRIVATE SECTOR SEEMS CONVINCED THAT IT CAN PARTICIPATE MORE FULLY IN STIMULATING LDC GROWTH AND THAT, IN THE PROCESS, IT CAN BENEFIT FROM EXPANDED MARKETS, MORE RELIABLE SOURCES OF SUPPLY, AND NEW INVESTMENT OPPORTUNITIES.

THE ROLE OF PRIVATE INVESTMENT IN DEVELOPING COUNTRIES

U.S. INVESTMENT HAS PLAYED A PARTICULARLY SIGNIFICANT ROLE IN THE ECONOMIC GROWTH OF MANY OF THE "SUCCESS STORIES" OF DEVELOPMENT, SUCH AS KOREA, TAIWAN, SINGAPORE, HONG KONG, BRAZIL AND THE PHILIPPINES. THE BENEFITS OF INCREASED DIRECT INVESTMENT FLOWS WERE, AND CONTINUE TO BE, ADDITIONAL EMPLOYMENT; ADDITIONAL CAPITAL TO EXPAND PLANT CAPACITY OR CREATE NEW FACILITIES; TRANSFERS OF NEW AND IMPROVED TECHNOLOGY AND MANAGEMENT SKILLS; INCREASED PRODUCTION; AND GREATER COMPETITION.

AS THE GLOBAL ECONOMY EXPANDS, INCREASING AMOUNTS OF CAPITAL WILL BE NEEDED TO SUSTAIN GROWTH. CAPITAL SCARCITY MAY WELL BECOME AN EVEN MORE IMPORTANT CONSTRAINT ON GROWTH THAN HERETOFORE. THIS CONSTRAINT IS DUE TO INCREASED INVESTOR PERCEPTION OF THE RISKS ATTACHED TO INVESTMENT IN SOME DEVELOPING COUNTRIES AND TO THE REAL LIMITS ON THE AMOUNTS OF CAPITAL AVAILABLE FOR BOTH DOMESTIC AND FOREIGN INVESTMENT. THE U.S. GOVERNMENT AND THE PRIVATE SECTOR BOTH HAVE A STAKE IN DEALING WITH THESE ISSUES IN WAYS WHICH MAINTAIN AND EXPAND THE OPEN INTERNATIONAL INVESTMENT SYSTEM SO NECESSARY FOR GLOBAL ECONOMIC GROWTH.

THERE RECENTLY HAS BEEN A SHARPENING OF DIFFERENCES IN THE ABILITY OF DEVELOPING NATIONS TO ATTRACT INVESTMENT. THE GROWTH OF INTERNATIONAL DIRECT INVESTMENT FLOWS FROM THE 14 MAJOR OECD COUNTRIES TO DEVELOPING NATIONS TAKEN TOGETHER HAS INCREASED OVER THE LAST FEW YEARS IN CURRENT AND REAL TERMS. FROM 1973-1978 THE AVERAGE ANNUAL GROWTH RATE OF THESE FLOWS TO DEVELOPING COUNTRIES WAS ABOUT 19 PERCENT, UP 10 PERCENT FROM THE PREVIOUS FIVE YEAR PERIOD. THE U.S. SHARE OF THESE FLOWS ACCOUNTED FOR A LITTLE LESS THAN HALF OF THE TOTAL DIRECT INVESTMENT IN DEVELOPING COUNTRIES. SUCH U.S. DIRECT INVESTMENT AMOUNTED TO $11 BILLION IN 1960, NEARLY DOUBLED IN 1970 TO ABOUT $19.2 BILLION, AND MORE THAN

DOUBLED AGAIN WITH THE 1980 FIGURE OF $52.6 BILLION. YET MOST OF THIS INVESTMENT HAS FLOWED INTO THE NEWLY INDUSTRIALIZED DEVELOPING COUNTRIES WHICH HAVE MAINTAINED ATTRACTIVE INVESTMENT CLIMATES. IT HAS PLAYED A MAJOR ROLE IN THE RAPID GROWTH OF MANUFACTURING IN THESE COUNTRIES--CONTRIBUTING TO THEIR EXPORT-LED ECONOMIC GROWTH.

IN CONTRAST TO THE EXPERIENCES OF THESE COUNTRIES, INTERNATIONAL DIRECT INVESTMENT HAS TENDED TO STAGNATE IN OTHER DEVELOPING COUNTRIES, WITH THE EXCEPTION OF THE OIL PRODUCING COUNTRIES. IT IS OF PARTICULAR CONCERN THAT DIRECT INVESTMENT IN MINERALS HAS STAGNATED IN RECENT YEARS. A GLOBAL SHORTFALL IN EXPLORATION AND NEW MINE AND SMELTER CAPACITY COULD RESULT IN FUTURE SHORTAGES AND/OR SHARPLY RISING METALS AND MINERALS PRICES WHICH, IN TURN, COULD CONSTRAIN FUTURE ECONOMIC GROWTH. MOREOVER, THE DECLINE IN MINING INVESTMENT MAY PREVENT SEVERAL MINERAL-RICH DEVELOPING COUNTRIES FROM MAXIMIZING THEIR EXPORT EARNINGS AND THUS TAKING FULL ADVANTAGE OF THEIR DOMESTIC GROWTH POTENTIAL. IT IS EXPECTED THAT THE BULK OF THE FOREIGN INVESTMENT CAPITAL REQUIRED FOR THE CREATION OF NEW MINING CAPACITY IN DEVELOPING NATIONS WILL LIKELY HAVE TO COME FROM PRIVATE SOURCES. ONLY A SMALL PORTION IS EXPECTED TO BE MADE AVAILABLE FROM NATIONAL AND INTERNATIONAL PUBLIC AGENCIES.

WHILE THERE ARE SECTORAL REASONS FOR LOW FOREIGN INVESTMENT IN MANY DEVELOPING COUNTRIES, THERE ARE OTHER "INVESTMENT CLIMATE" FACTORS, SUCH AS QUESTIONABLE NATIONAL ECONOMIC POLICIES, FEAR OF POLITICAL INSTABILITY, AND NEGATIVE POLICIES TOWARD FOREIGN INVESTMENT. INCREASED PERCEPTION OF POLITICAL RISK AMONG POTENTIAL INVESTORS IS A KEY FACTOR. UNCLEAR AND RESTRICTIVE INVESTMENT LAWS AND REGULATIONS, AND THE UNPREDICTABILITY OF THEIR APPLICATION, ARE OTHER IMPORTANT ELEMENTS, AS ARE THE INCREASED USE OF PERFORMANCE REQUIREMENTS AND RESTRICTIONS ON EQUITY HOLDINGS.

AS YOU KNOW, THE UNITED STATES HAS A STRONG INTEREST IN THE GROWTH OF DEVELOPING COUNTRIES. TAKEN TOGETHER THEY ARE A LARGER MARKET FOR U.S. EXPORTS THAN EUROPE AND JAPAN COMBINED. FOREIGN PRIVATE DIRECT INVESTMENT FLOWS ARE A MAJOR--AND CAN BE AN INCREASINGLY IMPORTANT--SUPPLEMENT TO OTHER FINANCIAL TRANSFERS, PRINCIPALLY OFFICIAL DEVELOPMENT ASSISTANCE AND COMMERCIAL BORROWING. IT CAN PLAY A UNIQUELY VALUABLE ROLE IN STIMULATING GROWTH IN DEVELOPING NATIONS.

THERE APPEARS TO BE AN INCREASING PERCEPTION BY MANY DEVELOPING NATIONS THAT INCREASING FOREIGN DIRECT INVESTMENT WILL BE VITAL TO THEIR PROSPERITY IN THE 1980'S. DESPITE THE NEGATIVE RHETORIC HEARD IN SOME QUARTERS, MANY DEVELOPING NATIONS ARE SEEKING ACTIVELY TO ATTRACT FOREIGN INVESTORS. THEIR SUCCESS WILL DEPEND LARGELY ON THEIR INVESTMENT CLIMATES.

CLEAR AND CONSISTENT INVESTMENT-RELATED LAWS AND REGULATIONS, IN CONFORMITY WITH THE PRINCIPLES OF INTERNATIONAL LAW, AND ACCORDING MOST-FAVORED-NATION AND NONDISCRIMINATORY TREATMENT OF INVESTMENT, ALONG WITH OTHER STEPS IN THE DIRECTION OF A MORE OPEN INVESTMENT ENVIRONMENT, WILL BE DETERMINING FACTORS IN THE DECISIONS OF INVESTORS.

THE U.S. GOVERNMENT IS SEEKING WAYS BILATERALLY AND MULTILATERALLY TO FACILITATE U.S. INVESTMENT IN THOSE DEVELOPING COUNTRIES WHICH SEEK TO ATTRACT FOREIGN INVESTORS:

-- THE IMPROVED TREATMENT OF FOREIGN-SOURCED PERSONAL INCOME WILL REMOVE AN OBSTACLE TO THE OPERATIONS OF OUR COMPANIES OVERSEAS.

-- THE NEW LEGISLATIVE AUTHORITY FOR THE OVERSEAS PRIVATE INVESTMENT CORPORATION (OPIC) WILL PERMIT IT GREATER FREEDOM TO SUPPORT PRIVATE INVESTMENT IN MIDDLE INCOME DEVELOPING COUNTRIES. IT WILL CONTINUE TO PROVIDE INVESTMENT INSURANCE AGAINST VARIOUS POLITICAL RISKS IN OTHER LDCS.

-- LEGISLATIVE CHANGES TO DEFINE BETTER THE EXTENT AND SCOPE OF THE FOREIGN CORRUPT PRACTICES ACT ARE

MAKING GOOD PROGRESS IN THE CONGRESS. IT IS CLEAR THAT BUSINESS IS UNFAIRLY BURDENED BY THE PRESENT LEGISLATION. CLARIFICATION OF THIS ACT WILL HAVE THE ADVANTAGE OF NOT IMPOSING OUR STANDARDS ON OTHER COUNTRIES YET CLEARLY DEMONSTRATING OUR POSITION AGAINST BRIBERY.

-- SUPPORT FOR EXPORT TRADING COMPANY LEGISLATION.

-- PROPOSALS ARE BEING CONSIDERED FOR THE EXPANSION OF TRADE AND DEVELOPMENT PROGRAM FUNDING FOR PROJECT FEASIBILITY STUDIES AND PROJECT DESIGN.

-- WE ARE ATTEMPTING TO NEGOTIATE BILATERAL INVESTMENT TREATIES WITH DEVELOPING COUNTRIES WHICH WOULD ENHANCE THE ATTRACTIVENESS OF INVESTING IN THESE COUNTRIES BY ESTABLISHING A COMMON FRAMEWORK AND LEGAL BASE FOR INVESTMENT PROTECTION.

WE ARE ALSO SEEKING TO GIVE NEW VITALITY TO AND TO BROADEN MULTILATERAL EFFORTS TO ENHANCE PRIVATE SECTOR INVESTMENT IN THOSE DEVELOPING COUNTRIES WHERE THE ENVIRONMENT IS CONDUCIVE TO PRIVATE SECTOR GROWTH. WE BELIEVE THE WORLD BANK CAN PLAY A HIGHLY EFFECTIVE ROLE AS A CATALYST FOR INCREASING INTERNATIONAL FLOWS TO DEVELOPING COUNTRIES. ON A BROAD BASIS ITS EFFORTS TO FOSTER MARKET-ORIENTED POLICIES

IN THE LDCs AND ITS SUPPORT FOR BASIC INFRASTRUCTURE HELPS PAVE THE WAY FOR PROFITABLE PRIVATE INVESTMENT. ON A PROJECT-BY-PROJECT BASIS IT CAN ATTRACT ADDITIONAL PRIVATE CAPITAL THROUGH CO-FINANCING AND OTHER FORMULAS THAT ENCOURAGE U.S. BANKS AND OTHER INVESTORS TO DO MORE IN THE LDCs. EVEN IF THE BANK FINANCES ONLY A PART OF A PROJECT, ITS PARTICIPATION IMPROVES THE CLIMATE OF CONFIDENCE BETWEEN FOREIGN INVESTORS AND THE COUNTRY IN WHICH THE INVESTMENT IS TAKING PLACE.

WITHIN THE BANK GROUP, THE INTERNATIONAL FINANCE CORPORATION HAS A PARTICULARLY IMPORTANT ROLE TO PLAY. FOR THE LAST 25 YEARS, IT HAS BEEN WORKING TO ENCOURAGE THE GROWTH OF PRODUCTIVE PRIVATE INVESTMENT IN DEVELOPING COUNTRIES. IT HAS A WELL-EARNED REPUTATION FOR DOING SOUND ECONOMIC AND FINANCIAL ANALYSIS AND FOR INVESTING ONLY IN PROJECTS WHICH HAVE A GOOD CHANCE OF EARNING PROFITS. AS A RESULT, ITS PARTICIPATION IN A SMALL PORTION OF AN INVESTMENT CAN ATTRACT PRIVATE PARTICIPATION IN THE LARGER PORTION OF THAT INVESTMENT. THE IFC DESERVES GREATER SUPPORT FROM DEVELOPED AND DEVELOPING NATIONS ALIKE.

WE SHOULD ALSO WORK WITH OTHER DEVELOPED AND DEVELOPING COUNTRIES TO STUDY POSSIBILITIES FOR A MULTILATERAL INSURANCE PROGRAM -- AS RECENTLY SUGGESTED BY WORLD BANK PRESIDENT CLAUSEN -- WHICH WOULD PROTECT INVESTORS AGAINST CERTAIN

POLITICAL RISKS IN DEVELOPING COUNTRIES. THIS COULD HELP TO FACILITATE INVESTMENT IN DEVELOPING COUNTRIES, AND GIVE GREATER CONFIDENCE TO NEW INVESTORS FROM COUNTRIES WHICH DO NOT HAVE THEIR OWN NATIONAL INSURANCE AGENCIES. SIMILAR IDEAS HAVE BEEN CONSIDERED BEFORE, BUT PERHAPS THE TIMING NOW IS MORE PROPITIOUS BECAUSE THE INTEREST AMONG POTENTIAL INVESTORS AND POTENTIAL RECIPIENTS IS GREATER. WE ALSO WELCOME THE INCREASED INTEREST SHOWN BY PRIVATE FIRMS IN ISSUING POLITICAL RISK INSURANCE IN DEVELOPING COUNTRIES AND ARE EXPLORING WAYS IN WHICH WE CAN COOPERATE MORE CLOSELY WITH THEM IN THIS FIELD.

WE HAVE BECOME INCREASINGLY CONCERNED OVER THE SERIOUS POLITICAL, SOCIAL AND ECONOMIC PROBLEMS FACED BY MANY COUNTRIES IN CENTRAL AMERICA AND THE CARIBBEAN. WE ARE CURRENTLY SEEKING TO COOPERATE WITH THE CARIBBEAN BASIN STATES IN A PRACTICAL WAY, TO DEVELOP PROGRAMS TO STIMULATE MORE RAPID ECONOMIC GROWTH IN THE REGION. THE U.S. PORTION OF THIS INITIATIVE WILL FOCUS IN LARGE PART ON ENHANCING THE ROLE OF THE DOMESTIC PRIVATE SECTOR IN THESE ECONOMIES. GROWTH OF A MODERN, EFFICIENT PRIVATE SECTOR IS IMPERATIVE TO PROMOTE PRODUCTIVE EMPLOYMENT IN THE REGION AND TO GENERATE EXCHANGE-EARNING EXPORTS. WE HAVE NO PRECONCEIVED BLUEPRINT FOR DETERMINING THE ACTIONS, JOINT AND SEPARATE, WHICH SHOULD BE TAKEN TO INCREASE REGIONAL PRODUCTIVE CAPACITY AND ACHIEVE NEEDED ECONOMIC REVITALIZATION. WE ARE NOW ENGAGED IN A

SERIES OF CONSULTATIONS WITH BASIN COUNTRIES AND OTHER POTENTIAL PARTICIPANTS TO DETERMINE THOSE TRADE, AID, AND INVESTMENT MEASURES WHICH, WHEN TAKEN IN COMBINATION WITH THE EFFORTS OF THE REGIONAL GOVERNMENTS THEMSELVES TO REDUCE INTERNAL CONSTRAINTS TO ECONOMIC GROWTH, WILL HELP TO REACH OUR LONG-TERM GOAL OF INCREASED ECONOMIC PROSPERITY FOR THE REGION.

NON-INVESTMENT ASSISTANCE

A NUMBER OF THE BUSINESSMEN WHOM WE HAVE CONTACTED HAVE SPOKEN ABOUT THE ADVANTAGES OF INCREASED PRIVATE SECTOR EXCHANGE PROGRAMS, PROVIDING EXPERTISE THROUGH INSTRUCTION HERE AND ABROAD. THIS COULD TAKE SEVERAL FORMS:

MANAGERS AND TECHNICIANS IN KEY ECONOMIC SECTORS COULD RECEIVE ON-THE-JOB INSTRUCTION IN THE UNITED STATES. FOR EXAMPLE, IN THE IMPORTANT AGRICULTURAL SECTOR, A LEADING AGRICULTURAL UNIVERSITY IN A LARGE WEST AFRICAN COUNTRY ALREADY SENDS FARM MANAGERS TO A COOPERATING AMERICAN MIDWESTERN UNIVERSITY WHICH ASSIGNS THE "STUDENTS" INDIVIDUALLY TO WORK ON FARMS FOR SPECIFIED TRAINING PERIODS OF SEVERAL MONTHS. THE TRAINEE RETURNS HOME MINDFUL NOT ONLY OF THE PRACTICAL INSTRUCTION RECEIVED, BUT OF THE AMERICAN

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PRODUCTS TO WHICH HE WAS EXPOSED -- THE TRACTOR, THE AIR CONDITIONER, THE NUTRITIVE SUPPLEMENTS ADDED TO FEED MIXES. SIMILAR PROGRAMS COULD BE ESTABLISHED FOR OTHER INTERESTED COUNTRIES AND IN OTHER KEY DEVELOPMENT SECTORS.

ANOTHER APPROACH SUGGESTED BY A NUMBER OF BUSINESSMEN IS ASSISTANCE BY U.S. PRIVATE SECTOR EXPERTS IN CRITICAL PHASES OF OVERSEAS PROJECTS. FOR EXAMPLE, AN EXPERIENCED MANAGER OR ENGINEER SERVING AS A CONSULTANT COULD MAKE A SIGNIFICANT CONTRIBUTION DURING THE START-UP PHASE OF A MANUFACTURING PLANT.

THIS TYPE OF AD HOC, "HANDS-ON" APPROACH IS ALSO USED SUCCESSFULLY BY THE INTERNATIONAL EXECUTIVE SERVICE CORPS. THERE SEEMS TO BE POTENTIAL FOR GREATER PRIVATE SECTOR CONTRIBUTIONS ALONG THESE LINES, BOTH ON A REMUNERATIVE AND A VOLUNTARY BASIS.

THERE ARE OTHER APPROACHES TO THE TRANSFER OF SKILLS AND KNOW-HOW; MANY ARE ALREADY IN USE. OVERSEAS BRANCHES CAN CONDUCT ON-SITE WORKSHOPS AND TRAINING PROGRAMS AT THEIR PLANTS AND REPAIR CENTERS, OPEN TO NON-EMPLOYEES AS WELL AS EMPLOYEES. THEY MIGHT SUPPORT LOCAL SCIENTIFIC AND EDUCATIONAL INSTITUTIONS.

VISITING AMERICAN EXECUTIVES CAN SERVE AS GUEST SPEAKERS AT FOREIGN UNIVERSITIES AND MANAGEMENT INSTITUTES AS WELL AS AT BUSINESS FORUMS. PEOPLE ABROAD WISH TO LEARN ABOUT AMERICAN BUSINESS TECHNIQUES. THE AMERICAN BUSINESSMAN IS STILL REGARDED, PERHAPS INCREASINGLY, AS HAVING THE KNOW-HOW TO VITALIZE AN ECONOMY. THE POWER OF EXAMPLE CAN HAVE SIGNIFICANT IMPACT.

THE REVERSE SIDE OF THIS APPROACH IS FOR THE PRIVATE SECTOR TO SPONSOR ATTENDANCE OF DEVELOPING COUNTRY PERSONNEL AT INTERNATIONAL SYMPOSIA AND FAIRS.

GOVERNMENT SUPPORT FOR BUSINESS

I HAVE MENTIONED IN PASSING SOME AREAS IN WHICH THE U.S. GOVERNMENT CAN HELP THE PRIVATE SECTOR IN ITS INVOLVEMENT IN DEVELOPING COUNTRIES. WHAT ELSE CAN WE DO TO ASSIST? LET ME STATE AGAIN MY FIRM BELIEF THAT GOVERNMENT SHOULD NOT ATTEMPT TO LEAD OR TO DOMINATE, BUT RATHER TO SUPPORT AND TO FACILITATE WHERE NEEDED. EXCELLENT ORGANIZATIONS, MECHANISMS AND SYSTEMS ALREADY EXIST, OUTSIDE AND INSIDE GOVERNMENT, WHICH CAN HELP U.S. BUSINESS TO DO MORE ALONG THE LINES I HAVE SUGGESTED ABOVE. THE STATE DEPARTMENT CAN ENCOURAGE AND, AT TIMES, ACT AS A CATALYST BY LINKING IDEAS, PERSONS AND INSTITUTIONS THAT CAN HELP MAKE THESE IDEAS WORK.

IN THE DEPARTMENT WE PLAN TO CONTINUE OUR DIALOGUE WITH BUSINESS LEADERS AND OTHERS FROM THE PRIVATE SECTOR SO THAT WE CAN UNDERSTAND THEIR NEEDS AT FIRST HAND AND SO THAT THEY CAN SHARE OUR THOUGHTS.

THE DEPARTMENT OF STATE AND OUR AMBASSADORS WILL ALSO BE PLAYING A MORE ACTIVE ROLE IN SUPPORT OF U.S. BUSINESS EFFORTS. SPECIFICALLY, WE WILL DO MORE TO ASSIST AMERICAN BUSINESS TO OBTAIN A LARGER SHARE OF THESE MARKETS AND SUPPORT THEM TO ENSURE FAIR TREATMENT OF THEIR INVESTMENTS AND A FULLER SHARE OF THE LICENSING, CONSULTING AND OTHER SERVICE CONTRACTS SO INTRINSIC TO THE DEVELOPMENT PROCESS. WE ARE DETERMINED THAT THE STATE DEPARTMENT, IN FULL PARTNERSHIP WITH USTR AND THE COMMERCE DEPARTMENT, SHOULD FORM PART OF A "BUSINESS FACILITATION TRIAD" WHICH WILL WORK FOR A MORE OPEN INTERNATIONAL TRADING AND INVESTMENT SYSTEM IN WHICH U.S. COMPANIES CAN COMPETE ON FAIR AND ATTRACTIVE TERMS FOR PARTICIPATION IN LDC MARKETS AND DEVELOPMENT.

SECRETARY HAIG HAS INSTRUCTED OUR AMBASSADORS TO ASSIGN VERY HIGH PRIORITY TO SUPPORTING AMERICAN BUSINESS ABROAD AND TO ENCOURAGING LDC GOVERNMENTS TO DEVELOP A MORE HOSPITABLE ENVIRONMENT FOR U.S. BUSINESS AND FOR PRIVATE

ENTERPRISE IN GENERAL. HE WAS VERY CLEAR IN HIS RECENT INSTRUCTION TO ALL AMBASSADORS:

> "I LOOK TO YOU TO INVOLVE YOURSELF PERSONALLY IN LEADING THE U.S. GOVERNMENT COMMERCIAL EFFORT IN YOUR COUNTRY." [THERE CAN BE NO] HALF-HEARTED, UNSUSTAINED EFFORTS OR LIP SERVICE. IT MUST BE A CONVICTION AND A MAJOR PURPOSE IN YOUR AMBASSADORIAL STEWARDSHIP."

IN MY BUREAU, FOR ECONOMIC AND BUSINESS AFFAIRS, WE HAVE STRENGTHENED THE OFFICE OF COMMERCIAL AFFAIRS AS THE CENTRAL POINT FOR SUPPORT FOR THE BUSINESS COMMUNITY. THIS OFFICE WILL AID IN EXPORT PROMOTION EFFORTS, THE REMOVAL OF EXPORT DISINCENTIVES, AND IN HELPING SOLVE PROBLEMS FOR BUSINESS ABROAD BY CUTTING THROUGH THE BUREAUCRATIC TANGLE WHICH FREQUENTLY PREVENTS TIMELY SOLUTIONS.

THE TRADE REORGANIZATION ACT OF 1979 ESTABLISHED THE NEW FOREIGN COMMERCIAL SERVICE, ADMINISTERED BY THE COMMERCE DEPARTMENT, TO HANDLE EXPORT PROMOTION EFFORTS WITH OUR MAJOR TRADING PARTNERS. THE STATE DEPARTMENT IS WORKING IN FULL COOPERATION WITH THE NEW SERVICE TO ENSURE ITS SUCCESS, IN ADDITION TO URGING AMBASSADORS AND OTHER SENIOR EMBASSY

OFFICERS TO DO SO. THE STATE DEPARTMENT IS DIRECTLY INVOLVED IN THE COMMERCIAL BUSINESS, PARTICULARLY IN THE DEVELOPING WORLD. WE RETAIN DIRECT RESPONSIBILITY FOR COMMERCIAL WORK IN 75 COUNTRIES WHICH TOGETHER PURCHASED OVER $16 BILLION IN U.S. MERCHANDISE AND AGRICULTURAL EXPORTS IN 1980. IT IS IMPORTANT TO SUPPORT U.S. EXPORT EFFORTS IN THESE COUNTRIES IN THE MOST EFFECTIVE WAY POSSIBLE AND WE PLAN TO DO SO IN WAYS THAT WILL BENEFIT BOTH ECONOMIC GROWTH IN OUR OWN COUNTRY AND IN THE DEVELOPING NATIONS.

JUST AS IMPORTANT, HOWEVER, IS A UNIQUE CONTRIBUTION THAT THE STATE DEPARTMENT AT HOME CAN MAKE IN SUPPORT OF AMERICAN BUSINESS IN THE DEVELOPING NATIONS. FREQUENTLY SENIOR EXECUTIVES OF MAJOR U.S. MULTINATIONAL CORPORATIONS HAVE LESS OF A NEED FOR SPECIFIC COMMERCIAL SUPPORT THAN FOR BACKGROUND AND ANALYSIS ON WHICH TO BASE THEIR STRATEGIC PLANNING AND RISK ASSESSMENT. AT THE STATE DEPARTMENT THERE EXISTS A BROAD RANGE OF ESSENTIAL POLITICAL AND ECONOMIC INFORMATION AND JUDGMENT WHICH CAN BE OF CONSIDERABLE VALUE TO AMERICAN COMPANIES MAKING DECISIONS ABOUT FOREIGN OPERATIONS. THE DEPARTMENT WILL BE FULLY RESPONSIVE IN SHARING THIS INFORMATION AND PERSPECTIVE APPROPRIATELY WITH BUSINESS.

IN CLOSING, I WOULD LIKE TO NOTE A NUMBER OF SPECIFIC ACTIONS WHICH HAVE ALREADY BEEN IMPLEMENTED BY THE REAGAN ADMINISTRATION TO REDUCE EXPORT DISINCENTIVES:

-- A PREVIOUS POLICY REGARDING ARMS SALES HAS BEEN CHANGED; OUR EMBASSIES CAN NOW PROVIDE THE SAME COURTESIES AND COMMERICAL SERVICES TO FIRMS SELLING DEFENSE EQUIPMENT AS THEY DO FOR OTHER BUSINESSES.

-- THE EXPORT-IMPORT BANK RESTRICTION ON LENDING TO CHILE WAS LIFTED EARLY IN THE YEAR.

-- LICENSES FOR EXPORT OF FIVE CIVILIAN BOEING AIRCRAFT TO IRAQ, HELD UP FOR MORE THAN A YEAR, WERE ISSUED IN MAY.

WE HAVE SET IN MOTION A VIGOROUS POLICY OF SUPPORT FOR THE U.S. PRIVATE SECTOR AT THE STATE DEPARTMENT AND OUR EMBASSIES -- A POLICY WHICH HAS AS ITS CENTRAL OBJECTIVE A MORE ACTIVE AND RESPONSIVE ROLE IN ENCOURAGING AND ASSISTING AMERICAN BUSINESS TO PLAY THE ESSENTIAL ROLE THAT WE KNOW IT CAN, AND CAN BENEFIT FROM, IN THE DEVELOPING WORLD.

Senator ROTH. Mr. Secretary, I don't know whether you were here earlier or not, but as I listened to your statement, my concern is to what extent are people like yourself who enjoy a prestigious position within the State Department going to help private enterprise become competitive in world markets, particularly the Third World? I'm somewhat concerned after hearing you and looking quickly at your prepared statement, I don't see anything that spells out with any particularity the problem that is articulated so well in a recent article by CSIS, which I know you respect as much as I do, where it says:

> The failure of the U.S. Government to fight for its industrial markets is resulting in major long-term losses. The aid budgets of our competitor governments are an important weapon in this war. If the U.S. wishes to participate significantly in the Third World markets where the majority of future economic growth is to take place, we must develop an industrial policy similar to its agricultural policy. We have to incorporate aid policy which encourages domestic and overseas investment in foreign policy.

I don't want to read the full statement, but as I indicated earlier, of course, the President himself has certainly articulated his desire to move in a new direction and that much more of the burden or role is to be played by the private sector, but how are we going to do that? How is American business going to be able to move into the Third World markets, not only around the rim of Asia where it seems to me the success story is very clear, but in Africa and elsewhere, unless we can play the game by the same rules our competitors play?

I would like to hope that we could limit in certain areas some of the practices and policies, but what is the answer? How is American business going to compete? I'm not only talking about investment. I mean export-import credits and the whole range of weapons, if you want to call them that, that are being used by other countries?

Mr. HORMATS. I think you put your finger on the key point. The growth of these developing country markets, is higher on the average than that of the developed country markets. They absorb about 36 percent of the total exports today from the United States, which means that they are important and their growth is important.

Now there are a number of things that we are trying to do. First, let me say that we are going to have some competitive difficulties from the very strong dollar because it does two things: Not only does it affect our own bilateral balance with, say, Western Europe, but it means that Western European countries are for the moment more competitive in Third World markets than the United States. And while they complain a lot about the effect of high interest rates on their economies, they don't talk much about the fact that the exchange rate changes as a result of the high interest rates have made them much, much more competitive both in their own market and in Third World markets, particularly Third World markets whose currencies are attached to the dollar. This is going to be one of the very difficult problems we're going to have.

Eximbank, in my judgment, is a critical factor because we are getting beaten regularly because other countries simply have either more financing or softer financing available. Therefore, one of the important things is to get the agreement on export credits worked out relatively soon so that we don't lose; not because our products aren't competitive because in many cases they are quite competitive, but because the financing we provide is less competitive. That is a major problem, particularly in the Third World.

Second, it's much more important than ever before that the U.S. ambassadors around the world play a more aggressive role in promoting U.S. exports. When you go around the world, the French ambassador, the British ambassador, the Japanese ambassador are salespeople. They go out there and they don't just go in with the light touch. If they want to sell something like a nuclear reactor, they go in and twist arms. Traditionally, we haven't done that. It's particularly important in the developing countries, not that we ought to be constantly pushing products where they are not competitive, but we shouldn't lose out where we are competitive, simply because other countries apply more pressure.

Training can also be an extremely powerful source of follow-up. I think we've got to use our own aid programs more creatively to work with the private sector.

One of the more interesting programs we have is under the Department of Agriculture, called the cooperative program. U.S. producers work with particular groups in developing countries, for instance, by helping a Nigerian farm or group of farmers to utilize soybeans more efficiently. That leads to a number of follow-on sales of U.S. soybeans. By and large, we are working with these developing countries in that area rather well, but I think we have to do it on a full-time basis. If we don't do that, we will find ourselves increasingly losing shares of these very long-term and very large markets.

I think you're absolutely right that in the decade of the eighties, the real contest is for the Third World markets. That's really where the competition is today, and the Japanese have an edge on all of us in many of the countries in Southeast Asia and the Europeans have a traditional edge in Africa and some parts of the Middle East, although I think we can make some encroachments on this. The French, for instance, have West Africa almost totally locked up.

Senator ROTH. It's that that greatly concerns me and it's also the fact that I find this Government, this bureaucracy, with all due respect, moves very slowly. These are not times where we can take years to rethink. The competition is there now.

Let me ask you this question. You know, traditionally, we have all sort of thought that aid should be pure. It shouldn't be in any way tainted by being associated with the sale of domestic products.

What's wrong with using foreign aid together with the private sector in trying to develop major products that will be of long-term benefit to both countries?

Mr. HORMATS. We are in fact doing that. In Egypt, for instance, we have for the first time provided mixed credits. The reason is quite simple. We provide enormous amounts of aid to Egypt and it goes for a lot of things. About a year and a half ago, the Europeans won a huge telecommunications project; they did it largely through mixed credit financing. We have decided we'll do the same thing and we are in fact doing that in Egypt. We have just started, so I don't think there are any major projects we've won as a result. We are also considering a project in Zimbabwe.

One of the difficulties is that there are very few countries in which our aid is large enough to make much of a difference. We have large aid programs in Israel, Egypt, Pakistan, Zimbabwe, and other countries, but in other countries around the world we have maybe $20 or $30 million and it's hard to really make that work with the big ticket items that we're talking about, like reactors or telecommunications.

Senator ROTH. As I suggested earlier, you might help develop a constituency if it could be seen to have a beneficial impact here at home.

Mr. HORMATS. I totally agree with you. The Europeans and the Japanese fully understand how dependent they are on the developing countries and how important aid is to keeping those markets. On the other hand, there's very little understanding in this country that we export more to the developing countries than to Europe and Japan taken together. We export about 12 percent of our GNP; 4 percent of the GNP is exported to the developing world, and that's important. If you look at aid as an investment in the future of these countries and of our own export prosperity, the linkage is something we ought to talk about. I totally agree with you.

Senator ROTH. I want to ask one question and then I'm going to turn it over to Representative Richmond. You mentioned that the Secretary of State—and I was very appreciative as the one who initiated it—that we instruct our ambassadors that trade was one of their principal purposes. I wonder, has the Secretary of State sent a message to our ambassadors to cooperate with AID missions in identifying where private sector approaches would be effective? It seems to me if he hasn't, that this would be highly desirable and that it be done in writing.

Mr. HORMATS. I give you full credit for the first letter, for suggesting the first letter on trade, and I think we can collaborate on another letter on the subject. It's a good idea.

Senator ROTH. Very good. Representative Richmond.

Representative RICHMOND. Thank you, Mr. Chairman.

Mr. Secretary, you know that U.S. investment has been centralized in newly industrialized countries. Now a decade or more ago those countries received soft loans from us; right?

Mr. HORMATS. Right.

Representative RICHMOND. Now without administration support for IDA VII and other soft loan windows, where are any new industrialized countries coming from? It's my understanding right now that the administration doesn't really support soft loans. You yourself said it was because of the soft loans that we have been able to develop some of these countries.

Mr. HORMATS. First, we have not made any public pronouncements on IDA VII because we're devoting our energies to getting IDA VI through; that's really our objective at this point. The point is well taken. There's no question but that for a number of developing countries their overall creditworthiness is not adequate to enable them to borrow very much on the private capital markets and there are a number of projects in those countries, particularly humanitarian projects, which require the very soft money that IDA provides.

Representative RICHMOND. The fact was that the soft loans that were made 10 or 15 years ago have proven out quite well for American business people.

Mr. HORMATS. I think very well. As a matter of fact, many of the countries which received soft money 10 or 15 years ago are today borrowing a large portion of their money on the private capital markets. They have graduated up.

Representative RICHMOND. Can you give us some examples?

Mr. HORMATS. The Philippines is one. I think a number of the countries in East Asia, Indonesia, Venezuela is another, I'm sure there are several others. Even India borrows today in the private capital markets. There are several.

Representative RICHMOND. So the soft loans we made 10 or 15 years ago have turned out well?

Mr. HORMATS. I think they have.

Representative RICHMOND. Yet we have a policy now which seems to be negative on soft loans.

Mr. HORMATS. It's not so much negative on soft loans; rather the overall objective policy is to look at investment and trade and aid as parts of a whole. Recognizing that there are going to be major limits on our ability to increase our aid budgets, we'd better use the aid we've got as effectively as we can. I think if we had our druthers, we would have more money in the budget.

Representative RICHMOND. The heads of both OPIC and AID stress the need to stimulate energy development around the world, yet our administration opposes a World Bank energy program.

Mr. HORMATS. We took a very hard look at the World Bank Energy Affiliate. The conclusion we come back to is that the World Bank today, first of all, provides about 27 percent of its funds in the energy area, most of it in hydroelectric power. Oil is only a relatively small amount. For each of those projects the World Bank takes 40 percent of the project and the private sector or other aid donors take the remaining 60 percent. Our thought is that if the World Bank can use the funds it has and take a smaller percentage of an individual project, getting more co-financing—in other words, instead of 40/60, the World Bank does 30/70—then you get a greater World Bank effort in the energy area with existing funds and without a new institution. And given the fact that we are having a hard time getting IDA and the World Bank appropriations through, we felt this was both correct economically and realistic in terms of the strategy.

Representative RICHMOND. Mr. Hormats, perhaps you can have some comments on this latest sale of butter to New Zealand. It's upset a lot of Members of Congress and a lot of the general public. Wearing again my agriculture hat, I have received an enormous amount of mail from people around the United States asking why we are willing to ship the Russians very helpful soybeans, wheat and corn, and yet we are not willing to sell them nonpolyunsaturated butter. We then ship this butter to New Zealand at half the value, knowing full well that the New Zealanders will ship it to the Soviet Union anyway. If that represents the Department of State policy, how can we change that policy so we have some policy that makes sense? We have billions of dollars worth of surplus butter, cheese and dried milk which we'd love to get rid of. Certainly the Russians can use some of it. Why is it OK to ship grain which is a cheap and healthful product in the world today and we won't ship them dairy products,

Mr. HORMATS. Well, it's a good question and let me try to answer it.

Representative RICHMOND. And you're from the State Department and you should know.

Mr. HORMATS. Let me try to answer as best I can. Let me put it this way. It was an imperfect sort of deal. I do not regard it as the best of economic deals in the world.

Representative RICHMOND. It was the worst from all sides.

Mr. HORMATS. Basically, there are a number of forces that came to bear on this issue. One, there was a very strong feeling that for political reasons—and this view was held not just by the State Department but by others in the administration—for political reasons, it was not a good idea to sell subsidized butter—or subsidized anything—to the Soviet Union.

Two, there was a desire on the part of Agriculture to get that butter out of our stocks because of the high cost of storing it.

Representative RICHMOND. I know. It was getting rancid.

Mr. HORMATS. It also costs money to keep it there. Given those two sets of demands, this was the best way of meeting them.

Representative RICHMOND. All we did was cost the American taxpayers some $100 million and we didn't gain anything, because everybody knows the butter is going to the Soviet Union anyway. The New Zealanders can't use the butter.

Mr. HORMATS. It's fungible. If you put more butter on the market you probably do open up new markets for New Zealand butter or some other butter; that's right.

Representative RICHMOND. Don't you think that policy was a little ridiculous and don't you think we should adopt a policy of shipping processed surplus foods to the Soviet Union?

Mr. HORMATS. It's what I think I would be eager to adopt.

Representative RICHMOND. Can we say, then, in the future that probably won't happen? We've had an enormous amount of people that are upset.

Mr. HORMATS. I can't guarantee that it won't happen again, but my instinct is that it won't happen again.

Representative RICHMOND. Is there a chance of the State Department assisting our own agriculture people in selling some of the dairy products to the Soviet Union right now?

Mr. HORMATS. I'd like to look into that. I don't know what their needs are at this point.

Representative RICHMOND. We have several billions of dollars worth just overhanging the market in the warehouse in Kansas City.

Mr. HORMATS. Again, a lot of it is in our stock because of subsidies; you come back to the same problem.

Representative RICHMOND. Whose policy is it that we can't ship subsidized food to the Soviet Union? As it is, we are shipping commodities to them at the cheapest prices in the history of the modern world—corn at $2.30 a bushel today is probably cheaper than it was during the Great Depression if you index it back for inflation. So we're shipping to the Soviet Union and China and Japan the very lifeblood of the United States, our nonrenewable resources like grain, to these countries at ridiculously cheap prices. Why not ship something renewable like milk? Milk is not a nonrenewable resource. It's renewable.

Mr. HORMATS. The difference is that the other products may be cheap, but they are essentially at world market prices which are very close to world market prices. The butter would have been at a price considerably lower than the U.S. price.

Representative RICHMOND. It was older, too. It wasn't first quality butter.

Mr. HORMATS. Even cheaper for the quality of butter it was. But I understand your point.

Representative RICHMOND. But instead of selling it to the New Zealanders at 77 cents a pound, we still could have gotten $1.20 a pound from the Russians and not felt so foolish as we do. Could we depend on you, Mr. Secretary, to develop some sort of market for our surplus dairy goods?

Mr. HORMATS. I'll do my very best and I know you will be watching us if I don't.

Representative RICHMOND. We would really appreciate it because that $2 billion surplus is really upsetting our markets and if we could get rid of it, it would simplify our life tremendously. Thank you.

Senator ROTH. Mr. Secretary, I'll try to be brief. I do have a few more questions I'd like to ask you.

Even under the new direction of the private sector orientation, in my judgment, the coordination of the U.S. programs in the international area remains a problem. Do you foresee the administration presenting any modifications in their organizational setup? If not, you're talking about cooperating with the private sector, but how are you going to get them involved?

Mr. HORMATS. You've raised a good point. There are a number of programs throughout the Government that are run somewhat differently. There's no one common coordinating vehicle. With respect to Ex-Im, the broad policy guidelines are done in the National Advisory Committee which is chaired by the Treasury, State, Commerce, and other departments participate. The same agencies participate in the board of OPIC. The same agencies coordinate closely with Mr. McPherson in AID. There's no one overriding vehicle, one overriding instrument, that coordinates all of them. There was one, IDCA, but that's sort of, shall we say, on the back burner. It still exists, but it's not as active as it was.

Senator ROTH. And their proposal is to do away with it in the Senate foreign aid bill.

Mr. HORMATS. What it really boils down to is that the individuals who participate in all these things have to work closely with one another; in effect it's the same people who are developing policies in these various institutions. So the coordination is really more the individuals than any one instrument.

Senator ROTH. I understand a study has been made of the so-called Lome Convention between the European Communities and the African former colonies and that study shows there's been a loss of business for the United States. Have we considered using the same approach with respect to the Caribbean?

Mr. HORMATS. We have considered something similar. The Lome approach essentially involves commodity agreements which boost the prices of commodities when they come into the European Community; such agreements would encounter some opposition here. The Lome countries also have special access for products other than GSP products, like tomatoes; if you did the same thing here you'd run into a tomato problem very quickly. We've thought about it, but there are a number of problems that would confront us. In the Caribbean area, we're now working on ways of giving some preferential access to our market in certain GSP products. I think it's useful if you can limit it to the Caribbean. If we start giving these sorts of things to a lot of countries, then first of all, we won't get domestic support and, second, the benefits to the Caribbean are lost. But I think in the Caribbean some special treatment is desirable for economic and political reasons and I believe it is domestically salable.

Senator ROTH. I believe you stated that you wanted to develop mutilateral insurance programs. Would this require new legislative authority and, if so, who would be the lead agency?

Mr. HORMATS. If there were new legislative authority, Treasury would be the lead agency working with State and OPIC. The idea is really in the early stages. We have begun to push the idea a bit. Now we've got to work with the World Bank to try to develop the concept because then it would be part of the Bank. I suspect you may need to amend the articles of the Bank in order to do it and this study will probably go on for the next year or so before we have anything close to a specific agreement.

Senator ROTH. One final question. A number of countries have done a great deal more in making an effort to train technicians or seen training as a key area where business can make a contribution. I understand that Germany, for example, trains four times as many people as we do. The great advantage to this, as I understand it, is that if they were trained in German goods and technology, then they order them.

Mr. HORMATS. Right.

Senator ROTH. What are we doing in this area?

Mr. HORMATS. Not enough.

Senator ROTH. What do we plan to do?

Mr. HORMATS. When you look around the world, at the Europeans, they have done this in a number of areas. In the industrial areas their private firms do it and the government does it; the follow-on benefits are enormous, at very, very small cost for the amount of benefit received. We, over the last decade, have in fact cut back on this training and our private foundations just don't have enough money to do it. It's very interesting if you go to some of the developed countries—most of their military have trained here and understand how to deal with the United States and buy American equipment. The same is true in the industrial area. I think it's a problem. For instance, in the energy area we are considering the possibility—and I think we are going to do it—of developing a more extensive program for training energy experts in the United States, so they know how to use our technology and to produce more energy in their country, which is the major objective, but they will use more of our equipment. We are not doing it. Overall, we haven't done enough of it for the past decade and I don't foresee any real possibility of increasing that very dramatically.

Senator ROTH. I realize we have to wrestle with the long-term implications.

Mr. HORMATS. I agree with that. I believe it's a very high, long-term opportunity cost. But the British get a lot from this approach. In some countries where they have engaged in a lot of training they do still retain very close export ties.

Senator ROTH. Well, I appreciate you coming up today. I would like to underscore and reemphasize that I think we need some dramatic new thinking in this area. I think it's of critical importance that if we're serious and not merely giving lip service to the private enterprise playing a major role in helping the Third World develop that we have to take a tough look at our policies and better coordinate our aid and other programs. We can't let the victims of the past control the policies of the future. So I'll be looking forward very strongly to leadership from you and the State Department. I would suggest that I think it would be helpful, as I said earlier, that we again examine this whole area in about 6 months to see where we have moved in government affairs. I'm very much interested in the organizational aspects of the problem. So I look forward to continuing the dialog and hearing about the great actions being taken.

Mr. HORMATS. Thank you, Mr. Chairman. I look forward to the opportunity.

Senator ROTH. Thank you.

Our final group of witnesses today are a panel of three. Since the subject of this hearing is how business and government can cooperate, we thought it would be useful to also hear from actual businessmen who have had experience doing business with the Third World. I'd like to welcome Mr. Joseph Alibrandi, president, Whittaker Corp.; Mr. George Andrews, vice president, Morrison-Knudsen; and Paul Gibson, president, INTERACT. I welcome you, gentlemen, because I think you can give us great insight and better understanding as to what you think needs to be done to help business play a key role. I see we have—I'm very happy to welcome a fourth member of the panel, a lady. Welcome to all of you. I'll let you proceed as you see fit. You may want to introduce the lady.

STATEMENT OF JOSEPH F. ALIBRANDI, CHAIRMAN, SUBCOMMITTEE ON INTERNATIONAL ECONOMIC DEVELOPMENT, CHAMBER OF COMMERCE OF THE UNITED STATES, ACCOMPANIED BY KATHRYN YOUNG, ASSOCIATE DIRECTOR, MIDDLE EAST AFFAIRS

Mr. ALIBRANDI. Thank you, Mr. Chairman.

As you indicated, I'm Joseph F. Alibrandi, president of Whittaker Corp. of Los Angeles, and chairman of the Subcommittee on International Economic Development of the U.S. Chamber of Commerce. Appearing with me are Paul R. Gibson, president of INTERACT, San Francisco; and George H. Andrews, vice president, Morrison-Knudsen Co., Inc., Boise, Idaho. Accompanying us is Kathryn

Young, associate director, middle east affairs, from the chamber of commerce, and I might add, a very competent and knowledgeable staff person in this area.

We have prepared a statement, but with your indulgence, I would like to spare reading the prepared statement to you because I believe your subcommittee is truly more interested in the perceptions that we see resulting from what we sense is a changing philosophy toward international trade, or the role the United States will play in international trade.

Senator ROTH. Your prepared statement will be included in the record.

Mr. ALIBRANDI. I think we all heard the President's address last week, and I must reflect on his simple story regarding the fact that if you give a hungry person a fish you quench his appetite for a day or so, but really you haven't dealt with his fundamental problem of hunger. The way to do that, hopefully, is to teach him how to fish, provide him with the know-how and techology to do so, and then maybe you have dealt with the fundamental problem that we face around the world. I think that analogy is clearly the signpost, if you will, for what we see as a major challenge to U.S. industry and the private enterprise system to help build a free enterprise philosophy in developing countries.

We think there are a number of ways that we—industry and the Government—can and should work together much more cooperatively than we ever have in the past. Just this morning we presented to the International Policy Committee of the chamber a general philosophy addressing the issue of how industry and the Government can better work together. We have found ourselves in situations where, from a competitive point of view, our Government up to now has taken the position that developing countries are free markets in which we should operate on a free market basis; and speaking for myself, most of my industrial colleagues, and certainly for the chamber, our philosophy, too, is a free market philosophy. Domestically we are prepared to compete with any other company delivering the same products as ours.

The problem is that when you get into the international environment the ground rules are different. If our Government adopts the philosophy that our companies go out there by themselves and compete, we find ourselves competing not against a German or French or Japanese company, but against a consortium of Japanese or German or French companies and their governments.

Our proposal this morning to the chamber was that we change that philosophy. We absolutely don't want to get into a situation where the U.S. taxpayer subsidizes a company that is inefficient or unable to compete on a fair basis. We nevertheless feel that when a foreign country changes the competitive atmosphere, the United States ought to serve notice that it is prepared to compete as a partner with American business against foreign partnerships.

Our feeling is that in many ways we have tended to isolate our foreign aid and other programs from our desire to build free enterprise systems in developing countries.

As an example, the Swedes put together "mixed credits" to build an automobile plant in a developing country. They are very competitive.

Senator ROTH. Explain so it's clear to me and for the record what you mean exactly by mixed credits.

Mr. ALIBRANDI. By mixed credits, I mean they combined foreign aid grants with special financing and so forth in order to build that automobile plant at a very, very competitive price; an unrealistic price if a company had to undertake that project on a free enterprise basis. Their objective is that, once having built the plant, maybe for 20 to 40 years it will buy spare parts from the companies in Sweden. Thereby, not only are they looking at the short-term prospect of building the automobile plant, but also at the long-term trade that it encourages.

Our feeling is that we need a closer partnership between our free enterprise efforts and all the Government agencies and special financing and insurance programs that the Government can provide. If a U.S. company proposes to build a project for $20 million, and a French company can build it for $18 million on a free, competitive basis, we do not think the U.S. taxpayer should subsidize that American company. But when the American company can be competitive with the foreign company, then the U.S. Government should assist that American company to the same extent that the foreign government would support its company.

Senator ROTH. How do you decide which can be competitive?

Mr. ALIBRANDI. One of the problems is the one you put your finger on, Mr. Chairman. Many times you don't know whether you're competitive until after the bids are open. In the process that I propose there may be situations where we, industry, working together with the agencies of the U.S. Government, may have, through market intelligence and so forth, a determination as to the kind of financing the other country proposes, and we could package our proposal to be competitive.

Unfortunately, much of that is not known before the fact. But if we effectively serve notice that the U.S. Government is not going to stand back and have its industry finish second in competitions because of unfair competitive advantages inposed by foreign governments, I think that will go a long way toward solving the problem.

Senator ROTH. Well, I don't mean to interrupt you, and I've got a lot of sympathy for what you're saying, but one of my concerns is that we don't want to develop a policy where we encourage business to say they aren't competitive so as to get government more involved from a financial view. Then there would be pressure from other businesses to claim that they're not competitive. What would prevent that from happening?

Mr. ALIBRANDI. Well, I think we'll always have a situation where people attempt to take advantage of whatever policies we have. But we do believe that in most international tenders—let's take a construction project, for example—the pricing can be evaluated on a pretty objective basis. Many of these projects—and I allude to the question you asked one of my predecessors here—many of these projects are lost because there's clear, open subsidization based on interest rates, or special guarantees, or mixed credits. By mixed credits, I mean this: Let's say Morrison-Knudsen was contracting to build a port facility; a foreign competitor might contract to build the port facility, but his government, as part of its aid program, would build all the road or highway infrastructure to that port facility, thus presenting a more appealing, more comprehensive package to a developing country. I think the construction project can be evaluated in terms of competitiveness pretty much on its own. I would like to ask Paul Gibson to comment with regard to the trade issues. Thank you.

[The prepared statement of Mr. Alibrandi follows:]

PREPARED STATEMENT OF JOSEPH F. ALIBRANDI

I am Joseph F. Alibrandi, President of Whittaker Corporation, Los Angeles, and Chairman of the Subcommittee on International Economic Development of the United States Chamber of Commerce. Appearing with me are Paul F. Gibson, President of INTERACT Corporation, San Francisco, and George H. Andrews, Director of External Affairs, Morrison-Knudsen Company, Inc., Boise, Idaho. Accompanying us is Kathryn Young, Associate Director, Middle East Affairs.

We wish to commend the Subcommittee for providing this opportunity to discuss the private sector dimensions of foreign aid policy. The Chamber's membership consists of over 174,000 firms and individuals, over 2,600 local and state Chambers of Commerce and some 1,200 trade and professional associations.

Traditionally, the Chamber has been an active supporter of effective United States development assistance programs since their inception over thirty years ago. The rationale for the Chamber's support is based on the simple proposition that the economic development of the Third World advances the political and economic interests of the United

States and is consistent with the moral principles for which this nation stands. A further proposition is that the economic systems most conducive to real growth are generally those which embrace open market, private enterprise principles.

The extent to which aid programs are able to foster these open market principles generally governs the extent to which they accomplish positive results.

In that regard, countries still struggling to achieve even basic self-sufficiency can learn much from the experiences of countries like Taiwan, Korea, Ivory Coast and Brazil.

The Subcommittee has requested the Chamber's views on the relationship between foreign economic assistance programs and U.S. foreign trade and investment interests. The panel is prepared to share with the Subcommittee personal views and experiences on the relationship. What follows is a brief overview of the major points to be addressed in aid policy that would facilitate optimum private sector participation.

At the outset, we would agree that there is a major conceptual difference between the approach of the United States and its major industrial competitors toward the role of foreign assistance. In the United States, the predominant tendency has been to isolate aid policy from other economic policies, domestic and international. The OECD competition, however, has tended to integrate aid policies into overall economic policies. The industries of the other OECD nations are assured of effective support from their governments in competing for Third World markets. American industries, on the other hand, cannot depend on any commensurate degree of support from the U.S. government. It has been noted that official U. S. policy on development assistance is intensely debated and minutely articulated. At the program level, however, the government commitment is much more vague and ambiguous. With the competition, though, it is the policy articulation that leans to the vague and ambiguous and the program execution that is sharp and forceful.

The new approach to U.S. development assistance policy being advanced by the Administration and the related emphasis on private sector involvement is supported fully by the Chamber. Business has a responsibility, however, to meet the government halfway with practical proposals on "how to" aspects of development, so that with Congressional support the Administration initiative will go beyond rhetoric to concrete action. First, the Administration has to tackle the problem of <u>credibility</u>.

A clearer reading on the broad program announced by President Reagan on October 15 will be possible when the results of the Cancun Summit Meeting are known. However, it is vital that the Administration communicate convincingly its commitment to certain institutions and objectives of special concern to Third World countries. This could begin with some reassurance on the role of the multilateral development banks. In many developing countries, some of the greatest obstacles to productive economic development lie in the serious deficiencies of the public sector. Investment in transportation, education, health, power generation and other aspects of basic infrastructure is imperative, and in such areas the expertise and terms of multilateral agencies can make a maximum impact. Other forms of aid from bilateral programs are also critical for these purposes. In view of the current domestic U.S. austerity program and tighter economic conditions in other donor nations, there is widespread skepticism in the Third World as to the strength of the Administration's will to follow through with efficacious aid policies. Many developing countries would be more inclined to consider greater market orientation in their economies if they were assured of U.S. good faith toward the multilateral lending institutions.

Although the United States presently absorbs the lion's share of Third World exports, Administration credibility could be boosted further by some greater attention to the problem of providing market access for the exports of developing countries. This is a timely agenda item for the Cancun meeting. Proposals for expanding the Generalized System of Preferences would be more convincing if exceptions were made more sparingly for products in which developing countries have acquired comparative advantages. This would also help validate U.S. emphasis on market forces as the most effective engine of development.

Second, the government must improve the <u>coordination</u> of programs concerned with the various aspects of foreign aid and economic activity abroad. The activities of the Export Import Bank, the Overseas Private Investment Corporation, the various Agency for International Development (AID) programs, the Office of the United States Trade Representative and others, all contribute to Third World development and further U.S. economic and commercial interests. Yet, their coordination is minimal. The reasons vary, from statutory provisions to bureaucratic red tape. The chief cause lies in the absence of a cohesive master plan for development, involving both the executive and legislative branches. It would seem that the Administration initiative provides Congress with the opportunity to explore directions that a master plan could follow and move to propose and implement the necessary administrative and legislative changes.

The Foreign Assistance Act with its numerous amendment is responsible for much of the lack of direction that has come to typify U.S. aid programming in recent years. The Basic Human Needs directive at the operational level has confounded the hopes of its creators and requires urgent attention with a view to removing its inhibiting effects on productive development strategies.

A third element concerns the importance of a truly open dialogue between the United States and developing countries on the issue of economic reform. Without resort to hectoring or patronization, much can be done to convince recipient governments of the mutuality of benefits that would follow from policies designed to encourage foreign and private investment and to foster open trade policies. The role of U.S. ambassadors is critical in this regard and will require consistent and positive reinforcement and direction from the Administration. The staffs of AID missions should also be strengthened to permit more initiative at the program levels. It is imperative that recipient states appreciate that they can do much to reduce the risk premiums associated with foreign investment. In particular, they can address the taxation and regulatory requirements and bureaucratic hindrances that imply an overly inhibiting effect on business activity.

A fourth area concerns a more forceful Administration and Congressional commitment to providing adequate program support to business in Third World markets. The operative question is whether the United States is prepared to defend markets that would be ours if the related transactions occurred on a purely commercial basis. If the answer is affirmative, a review of existing programs shows that we are far behind the competition.

The Subcommittee is familiar with the burgeoning use by our foreign competition of mixed credits and cofinancing. It is encouraging to note that President Reagan has announced the Administration's intent to increase cofinancing with the multilateral development banks. Initiatives in this direction are imperative together with continued and coordinated support for the Export-Import Bank and the Overseas Private Investment Corporation.

The Trade and Development Program (TDP) has been supported since inception by the Chamber and is capable of assuming wider responsibilities if the necessary resources were allocated. One promising activity could be for TDP to identify joint venture prospects in host countries, contact prospective local partners and submit the proposal for evaluation by U.S. management. The firms that decide to invest in such joint ventures could reimburse the costs involved.

Another program initiative, again requiring statutory guidance from Congress, would be to introduce more flexibility into programs financed under the Development Assistance (DA) Program of AID. One reason the Economic Support Fund (ESF) is so popular is the freedom that its administrators have to tackle projects on a case-by-case basis, giving full rein to initiative and timeliness. If similar qualities could be grafted onto other major program areas, their effectiveness would be dramatically enhanced.

The U.S. Chamber of Commerce endorses the emphasis on the private sector dimension of foreign aid policy that is being advanced by the Administration. Through its affiliation with American Chambers of Commerce Abroad and through the operations of its bilateral business councils, the Chamber is exposed to firsthand experience on the realities of conducting business in Third World countries. It is clear that our competition takes those markets seriously and, as a consequence, the respective governments work closely with their business sectors to enhance their performance. With relatively minor adjustments to the prevailing direction of U.S. aid and related programs, American business could offset much of the special advantages that its competition has taken for granted. To that end, closer consultation between business and government is a requisite. The Chamber's network of bilateral business councils and affiliated American Chambers of Commerce Abroad can play an important role in that connection. As an appendix, some recommendations of the U.S. Section of the Sudan-U.S. Business Council are illustrative.

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REDIRECTING AID'S PROGRAM IN THE SUDAN
Prepared by the U.S. Section
of the Sudan-U.S. Business Council
September 1981

Background

In response to requests from the USAID mission and embassy in Khartoum and State Department officials in Washington, the following set of suggestions has been prepared by the U.S. Section of the Sudan-U.S. Business Council A key element of the Reagan Administration's "new directions" in foreign aid policy and programs is a stated intention to make the private sector, both in the United States and in developing countries, a more integral part of U.S. economic development efforts.

A special eight member Development Assistance Committee of the U.S. Section of the Sudan-U.S. Business Council, chaired by Tracy Park, vice president, Tenneco Inc., was responsible for reviewing and organizing thoughts of all Council members on ways in which U.S. economic assistance funds might be redirected to serve better the needs of both the U.S. and the Sudanese private sectors over the next several years.

Dual Purpose of U.S. Foreign Economic Assistance

The Council committee concluded that programs and funding should respond to a specific set of needs, both from the perspective of serving broad U.S. foreign policy goals in the region and in meeting specific Sudanese economic development requirements. General needs were identified as follows:

I. U.S. Foreign Policy Goals

A. In any country U.S. economic, strategic, and political interests should work together to accomplish a given objective or set of objectives. This is particularly true in the Sudan where there is an emerging recognition by the United States of the strategic and political importance of the Sudan in the region as evidenced by the dramatic increase in U.S. security assistance over the past year. There is an opportunity to coordinate U.S. assistance funds in the Sudan to serve a number of our foreign policy objectives.

B. If the Reagan Administration's stated goal of redirecting U.S. economic assistance to involve the private sector is to succeed, it will take more than just a few projects labeled "private sector." Organizational and personnel changes will be necessary, in particular, on-site in the developing countries.

II. Economic Development Needs of the Sudan

The Sudan is involved in a painful process of economic recovery and is faced with a difficult task of building productive capability. Massive flows of external assistance are needed to assist the country in this process. These funds should be directed toward aiding economic recovery in the following areas:

A. Measures are needed to assist in improving the Sudan's negative balance of payments situation. Ways must be found to increase the Sudan's exports so that foreign exchange can be earned for development programs. In turn, to avoid the drain of foreign exchange, non-essential imports must be curtailed.

B. The steady decline in production must be halted. Contributing factors such as labor shortages, transport bottlenecks and scarce supplies of raw materials and spare parts must be addressed.

C. The Sudan's agricultural potential is well-known, but not yet realized. Agricultural output is declining steadily at a time when a world-wide food crisis is becoming imminent.

D. The Sudan's financial problems remain acute even as multilateral lending institutions attempt to assist the Sudan in meeting its financial obligations. Without the funds for development, economic recovery cannot take place.

Overview of the History of AID's Program in the Sudan

The level of funding for AID's program in the Sudan has increased significantly over the past several years from $7.3 million in FY 1977 to an anticipated $105.3 million in FY 1982. Along with this increase it appears has come a new flexibility in programming these funds.

In the 1977-1979 period AID's relatively small program in the Sudan was structured around the "new directions" mandate which requires that AID funds should be used in projects which will benefit the poorest element of the borrowing country. This mandate, while not actually prohibiting loans to industrial or infrastructure projects, emphasizes the satisfaction of human needs rather than physical capital investment. Soon after its formation in 1977 the Business Council advised AID that the small amount of funds budgeted for the Sudan, and the restrictive conditions applied to determine eligibility of projects for such funds, did not reflect either the Sudan's development needs, current circumstances or economic potential. The Council emphasized that projects to extend and modernize the Sudan's infrastructure would require financial support in the medium term, if only to permit the effective extension of social services to the ultimate beneficiaries. AID's FY 1980, 1981, and 1982 funding plans reflect an expansion of the program to encompass infrastructure and balance of payments support. The Business Council supports this broader AID approach to the Sudan's economic development.

U.S. Foreign Economic Assistance

	FY 78	FY 79	FY 80	FY 81	FY 82 Request
Economic Assistance					
Development Assistance	$ 7.6	$ 16.2	$ 30.1	$ 21.7	$ 27.0
Economic Support Funds	--	--	40.0	50.0	50.0
Food Aid	12.2	24.0	25.8	33.8	28.3
	$ 19.8	$ 40.2	$ 95.9	$105.5	$105.3
Security Assistance					
Foreign Military Sales Credits	--	--	$ 25.0	$ 30.0	$100.0
Military Education and Training	--	--	--	0.7	1.5
	--	--	--	$ 30.7	$101.5
Other	$ 2.5	$ .05	$ 1.5	--	--
TOTAL	$ 22.3	$ 40.25	$122.4	$136.2	$206.8

A Redirection

The following 24 suggestions have been prepared to respond to U.S. foreign policy and Sudanese economic development needs through redirecting AID monies to support private sector development projects. Further discussion between AID officials and representatives of the U.S. private sector would be valuable in determining the feasibility of each of these ideas.

REDIRECTING AID'S PROGRAM IN THE SUDAN
Prepared by the U.S. Section
of the Sudan-U.S. Business Council
September 1981

The following suggestions have been prepared to advance current U.S. foreign policy and development assistance goals and to meet the specific economic development needs of the Sudan through a redirection of AID funds and programs to support U.S. and Sudanese private sector initiatives.

I. <u>Suggestions to Advance U.S. Foreign Policy Goals for the Sudan</u>

A. Coordinate U.S. Government Assistance Programs

Recognizing the political/strategic importance of the Sudan, there is a need to coordinate political, military and economic foreign policy objectives and an opportunity to blend related assistance programs. Examples of possible coordination include:

1. Integrate military and economic assistance in a single project i.e., if the United States is helping to build a military base, also build connecting roads, and other infrastructure, or use military assistance for general port refurbishing at Suikan which could accommodate our naval ships.

2. Create a development opportunity using an off-set military agreement, i.e. reserve a part of U.S. procurement for the products of the Sudan. Use AID funds to build an industry that could manufacture new products for export. U.S. firms could take part in that development effort.

B. Increase Effectiveness of U.S. Government Private Section Orientation

Encourage the U.S. Embassy in Khartoum to concentrate its efforts on assisting U.S. companies to win major internationally funded contracts.

3. Target Suikan port development- early in 1982 an international tender for this port work will be released, the Germans have completed a prefeasibility study and Saudi money has been committed to the project. The U.S. Embassy could work together with U.S. companies to put a consortium together, perhaps by co-financing with some U.S. government funds and in general aggressively try to promote U.S. firms to obtain a major piece of the work.

4. Promote U.S. firms for AAAID (Arab Authority for Agricultural Investment) financed projects. U.S. firms have not been getting these contracts. Perhaps the embassy could promote the capabilities of U.S. companies better, attempt to find out what the barriers have been and try to resolve them.

5. Designate a person or persons in the AID mission in Khartoum to undertake responsibility for identifying, programming and implementing private sector projects. If need be, recruit a business person or banker for a temporary tour of duty.

II. Suggestions That Respond to Sudanese Economic Development Needs

A. Expand Exports and/or Provide for Import Substitution

6. Allocate a specific portion of Commodity Import Program (CIP) and Development Assistance (DA) funds (i.e. 60 percent each) for use by the U.S. and Sudanese private sectors. The money would be utilized for commercially viable import/substitution or export oriented projects which contribute to the Sudan's economic development. The programming of such funds would lie with the AID mission and U.S. embassy rather than the Minister of Commerce and Supply, which often employs AID funds inefficiently for politically -oriented public sector projects. (i.e. tallow). The funds should be for at least 80% content for purchase of U.S. goods and services. It is suggested that the CIP also be made available to reinforce existing private sector projects rather than restricted to new or expansion of current projects.

7. Create a bonded warehouse system which would then enable U.S. banks to finance the export of Sudanese cotton.

8. Assist export oriented industries by providing foreign exchange to purchase U.S. goods (inputs, spare parts, equipment) and services (technical and managerial).

9. Construct dual use commodity storage port facilities for imported and exported products.

B. Expand Industrial Capabilities

10. Provide industry-specific managerial, technical and vocational training, develop incentives to insure that once trained, personnel remain in the Sudan.

11. Provide AID funds directly to OPIC in order to facilitate U.S. direct equity investment.

12. Provide AID funds for direct equity investment in high-risk projects that are of top priority for the Sudan's development (i.e. agriculture, minerals). If not legally permissable, suggest utilizing convertible debentures which would be converted and sold at the earliest opportunity.

13. Provide Development Assistance project loans to help new local private sector or joint venture projects get started.

14. Raise the idea with the Sudanese government of considering using a U.S. company to act as their Economic Development Agency for the Southern Region to identify industrial, agricultural or other types of development projects, to work in the international market-place to finance these projects -- in general to develop a regional economic plan and carry through implementation. AID could help finance costs, require a training component to develop local capability. (Litton Industries undertook a similar role in Greece).

15. Reevaluate the exclusion of certain key items for the Sudan (i.e. sugar) eligible for the Commodity Import Program.

16. Expand the definition of CIP activities to cover services as well as goods provided by U.S. corporations (i.e. management and technical services) which are directed at improving the capabilities of local industries.

C. Realize Agricultural Potential

17. Use a pilot agricultural project between the Sudan and Egypt as a model to coordinate Egyptian and Sudanese economic assistance funds together with private sector capital. Involve the U.S. private sector throughout the process from planning through implementation. The combining of assistance monies might be as follows:

-- project identification - Egyptian, U.S., Sudanese private sectors
-- pre-feasibility study - TDP or AID funds
-- feasibility study - OPIC funds matched by interested company or companies funds -- the U.S. company(ies) would conduct the study
-- project financing and insurance - AID/OPIC/private commercial
-- design, construction, management, production, distribution, marketing - U.S. private sector directed, in partnership with Sudanese and Egyptian firms, include training component for locals
-- problem-solving "hand holding" removal of barriers - U.S. embassy personnel.

18. Provide funds to hire U.S. firms to assist in the Government of the Sudan's presently faltering crop protection program.

19. Provide funds for a turnkey project to revitalize the Sudan's fleet of agriculture airplanes for aerial spraying of crops - project to include ground support and pilot training.

20. Make counterpart PL 480 funds available for purchase of wheat seeds, chemicals and other inputs for Sudanese farmers in order to create an incentive for them to grow enough wheat to reach self-sufficiency.

21. Rehabilitate existing viable agricultural cooperative societies with equipment and spare parts.

D. Enhance Local Financing Capability

22. Provide a relatively small dollar loan to the Development Bank of the Sudan for on-lending on somewhat less liberal terms to the private sector for its use in funding foreign technicians. The loan from the Development Bank to the private companies concerned should be repaid in local currency over, say, 5-10 years with the interest rate not substantially higher than the interest rate on the AID loan to the Development Bank. Since the AID loan would presumably include tied procurement provisions, the result would be the utilization of U.S. technicians with their corresponding inclination to recommend U.S. equipment. Thus the long term balance of payment benefit to the U.S. would be significant.

23. Earmark a portion of locally generated funds from the CIP program to the Sudanese private sector to increase the availability of medium- and long-term loans and relieve the current strain on local bank overdraft facilities.

24. Make counterpart PL 480 funds available to the Sudan Development Corporation for loans to the Sudanese private sector.

Senator ROTH. Mr. Gibson, please proceed.

STATEMENT OF PAUL R. GIBSON, PRESIDENT, INTERACT, SAN FRANCISCO, CALIF.

Mr. GIBSON. Thank you, Mr. Chairman. I'd like to cover three quick points.

One is we have heard a great deal about the trade development program this morning which was formerly called the reimbursement program and, as you know, previously was used primarily to finance the U.S. Government agencies services like the Corps of Engineers and so on, and only recently has it been set up to plan for feasibility studies or so on using the private sector.

The U.S. Chamber pushed very hard to get this program and give it some independence. As a matter of fact, it was moved from the AID agency to a separate sort of agency, IDCA, for a period of time. Now it's moved back to AID and once again we believe it should be given more independence and divorced from AID and AID supervision and procedures to the maximum extent possible.

As to the trade development program role, I think here business feels it should only finance projects that have long-term advantage to U.S. firms on a long-term basis and with good return. In other words, if they're going to do a feasibility study for $1 million, it should have a potential of either a $100 million contract or at least something that's going to go on for a long time so the country gets our money back. But in order to do that, we need specifically some administrative rules changed for a trade development program to fund or to support specific U.S. projects which bring in a feasibility study or project design contract either for partial or complete trade development funding so that in effect the trade development program didn't have to at that point say, all right, Mr. Jones, this looks like a good program and we'd like to finance it; now we have to go out and competitively bid and bring in all your competitors and have them bid on it. There ought to be some mechanism similar to OPIC so when somebody brings in a bid and says we need your help to partially finance this, that deal would stand by itself.

We recognize that if somebody came in with the same deal there would be nothing wrong with the OPIC saying we'll do the same thing with them, but it doesn't open up the deal for everybody in the world to look at.

Another element is inadequate funding—we hear about this great program, the trade development program, which as you know spent about $4 million last year. And given the Reagan budget, was up for $10 million as I recall, but now with the continuing resolution we are probably back to $4 million. It doesn't go very far in feasibility studies these days, $4 million.

Now we have a suggestion that might make sense. That is, we would urge that aid funds could be channeled through the trade development program format whenever a good project comes up and where trade development funding is not available or not adequate. We'd like to submit that to you for consideration.

The second point, it seems to us, to get down to the gutsy points, is that when the aid program, whether it's U.S. aid or multinational banks, it seems to me what we hear our business colleagues saying is that these big infrastructure projects should not be financed today unless the host country has policies, laws, regulations, et cetera., that not only allow but indeed encourage two-way trade, local and foreign investment, technology transfer, and so on, to follow up and utilize fully those infrastructure projects when they are finished, whether they are dams or highways or whether they are educational.

It seems to me that's one of our problems. We build these projects in countries and yet the real breakthrough, the geometric development, doesn't follow because of the host country's policies on investment or trade for that matter.

My final point is at the recent international industrial conference in San Francisco, George Schultz, who advises the President, in a speech called for Mr. Claussen and the World Bank to establish a GATT for investment just on that particular point. He said we have had some success with the GATT for trade where countries of the world have more or less reduced their barriers; now we need a GATT for investments so the countries of the world will start reducing their barriers against investment.

All of us support OPIC and we think it's doing a good job and should be expanded, but I think it's a long step from a GATT for investment where the action is really needed to turn that around and make it an insurance policy issued by the World Bank. It seems if you contrast the two, the GATT for investment is something that's really needed and the World Bank could be the appropriate forum to make that happen.

So I'd like to urge the subcommittee to think seriously about a GATT for investments and try to uniformly bring down those impediments to investment around the world and particularly in those countries that get the benefit of our foreign aid program, both bilateral and multilaterally. Thank you.

[The prepared statement of Mr. Gibson follows:]

PREPARED STATEMENT OF PAUL R. GIBSON

Thank you, Mr. Chairman. I'd like to cover three quick points.

One is we have heard a great deal about the Trade Development Program this morning which was formerly called the Reimburseable Program and, as you know, previously was used primarily to finance services performed by U.S. Government agencies like the Corps of Engineers and so on, and only recently has it been set up to fund feasibility studies being carried out by private U.S. companies.

The U.S. Chamber pushed very hard to get the Trade Development Program more funding and to give it some independence. As a matter of fact, it was moved from the AID agency as a separate sort of agency, under IDCA, for a period of time. Now it's moved back to AID and once again we believe it should be given more independence and divorced from AID or to least from AID supervision and procedures to the maximum extent possible.

As to the Trade Development Program role, I think here business feels it should only finance projects that have an advantage to U.S. firms on a long-term basis and with a good return. In other words, if they're going to do a feasibility study for a million dollars, it should have a potential of either a $100 million contract now or at least a major contract that's going to go on for a long time so the U.S. gets its money back in spare parts, additional equipment, etc. But in order to do that, we need specifically some administrative rules changed for the Trade Development Program to fund or to support specific U.S. firms which bring in a feasibility study or project design contract either for partial or complete Trade Development funding so that in effect the Trade Development Program didn't have to at that point say, "all right, Mr. Jones, this looks like a good project and we'd like to finance it; now we have to go out and get competitive bids and bring in all your competitors." There ought to be some mechanism similar to OPIC so when a U.S. company brings in a project and says we need your help to partially finance this project, that project would stand by itself.

We recognize that if another company came in with the same project, there would be nothing wrong with the Trade Development Program saying we'll offer the same funding to them, but it doesn't open up the project for everybody in the world to bid on it.

Another element is inadequate funding—we hear about this great program, the Trade Development Program, which as you know spent about $4 million last year. And given the Reagan budget, was up for $10 million as I recall, but now with the continuing resolution we are probably back to $4 million. It doesn't go very far in feasibility studies these days, $4 million.

Therefore, we have a suggestion that might make sense. That is, we would urge that AID funds could be channeled through the Trade Development Program or even utilized under Trade Development Program format whenever a good project comes up and where Trade Development fundings is not available or not adequate. We'd like to submit that to you for consideration.

The second point, it seems to us, to get down to the gutsy points, is on the AID program, whether it's U.S. AID or multinational banks. It seems to me what we hear our business colleagues saying is that these big infrastructure projects should not be financed today unless the host country has policies, laws, regulations, etc., that not only allow but indeed encourage two-way trade, local and foreign investment, technology transfer and so on, to follow up and utilize fully these infrastructure projects when they are finished, whether they are dams or highways or whether they are educational.

It seems to me that's one of our problems. We build these projects in countries and yet the real breakthrough, the geometric economic development, doesn't follow because of the host country's policies on investment or trade.

My final point is at the recent International Industrial Conference in San Francisco, George Schultz, who advises the President, in a speech called for Mr. Claussen and the World Bank to establish a GATT for investment just on that particular point. He said we have had some success with the GATT for trade where countries of the world have more or less reduced their barriers; now we need a GATT for investments so the countries of the world will start reducing their barriers against investment.

All of us support OPIC and we think it's doing a good job and should be expanded, but I think it's long step downward from a GATT for investment where the action is really needed to turn that concept around and make it an investment insurance policy issued by the World Bank. It seems if you contrast the two, the GATT for investment is something that's really needed and the World Bank could be the appropriate forum to make that happen. I'm not against the World Bank issuing investment insurance, I just don't think this is nearly as important as a GATT for investment.

So I'd like to urge the subcommittee to think seriously about a GATT for investments and try to uniformly bring down those impediments to investment around the world and particularly in those countries that get the benefit of foreign aid program, both bilateral and multilaterally.

Mr. Chairman, in that regard, it seems to me there are three points we might leave with you. These are points that were made at out International Economic Development Subcommittee meeting last week. One is that when we talk about mixed credits utilizing U.S. aid funds, it is very cost-effective because those funds are in the budget anyway. We are not asking for new money.

There are two other points. Certainly, we appreciated your input and assistance in getting that excellent telegram out from Secretary of State Haig to all the American Ambassadors throughout the world to support U.S. business in developing both U.S. exports and investment. I think that will be very helpful. We passed a resolution at our committee hearing, and our good chairman is right here, at which we said we thought such a similar communication should go out to all the AID mission directors instructing them to cooperate with American business when they arrive on the scene, and then one by the Treasury Secretary to the U.S. directors of the World Bank, the Inter American Development Bank and the Asia Development Bank where we businessmen have not had very good relations in the past.

So I think communications like that which don't cost a thing would set the stage for closer cooperation between business and government and quasi-government.

RESOLUTION PASSED BY THE INTERNATIONAL ECONOMIC DEVELOPMENT SUBCOMMITTEE OF THE CHAMBER OF COMMERCE OF THE UNITED STATES AT A MEETING ON OCTOBER 14, 1981, JOSEPH ALIBRANDI, CHAIRMAN

"It is hereby resolved that the U.S. Chamber of Commerce should formally request Secretary of State Haig to send out an official telegram to all U.S. AID mission directors throughout the world instructing them and their staffs to extend full cooperation to all visiting U.S. businessmen in order to assist in promoting U.S. exports and investment.

"It is further resolved that the Chamber of Commerce of the United States should formally request Secretary of the Treasury Regan to send out an official letter to the U.S. executive directors of the World Bank, the InterAmerican Development Bank and the Asian Development Bank instructing them and their staffs to extend full cooperation to all U.S. businessmen visiting their banks in order to assist in promoting U.S. exports and investment."

—Proposed by Paul R. Gibson, President, INTERACT (International Business-Government Action).

Mr. ALIBRANDI. Mr. Chairman, I couldn't help but reflect on a question you asked one of the previous witnesses here, regarding what the State Department should do to encourage American exports and American investment overseas. In viewing the way American embassies work with American business overseas, as opposed to the way the British Embassy works on behalf of British industry, for example, my experience has been that there is almost an adversary relationship between American business and American embassies. We are beginning to see some change, but there has been an adversary relationship.

I'll give you an example. There's program in Saudi Arabia now for staffing and operating a major hospital complex in Saudi Arabia. The Saudi Arabians made a decision after conducting an international evaluation, that they wanted an American consortium to perform this task for them. Their first reaction from the United States was that, in order to enter into a government-to-government agreement on this, the United States would want to proceed with an international tender in order to have international competition.

Here's a case where the customer country had made the selection, chosen a U.S. consortium to do this work, and the United States reacted in a way that would have required the United States to oversee an international tender. Certainly, this is not a partnership kind of relationship, and I would find it very difficult to imagine the Japanese, or the British, or the French undertaking something of the sort.

As a matter of fact, in some discussion I've had with members of the French delegation, they thought that was humorous. They said, "With friends like your Government, you don't need us as competitors."

And so I think if we can encourage a working relationship—we're not looking for special consideration, but simply a relationship that permits us to use the assets that our Government has available in a partnership with private industry—we can help to develop a free enterprise system in those countries.

Having spent 18 or 20 years largely in the Middle East—in Saudi Arabia, the Sudan and so forth—I can tell you there are an awful lot of Americans there. And I think that above and beyond all the diplomacy that we spend huge sums for, the fact that Americans are there interfacing daily with Saudi Arabians and many Saudi

Arabians come here to the United States to go to school, creates the kind of environment that cannot be produced in any other way.

Maybe a small anecdote will give you an example. I remember taking the president to a major U.S. bank to Saudi Arabia. We went into the office of the Minister of Planning, and he was there in his Saudi Arabian garb with a number of consultants. As he saw me walk through the door—they were speaking Arabic—he said, "Who won the USC-UCLA game?" Obviously, he had studied here in the United States. I had to come away thinking that in any high council deliberations regarding the United States, he would bring balance to the discussion by virtue of the fact that he was educated here. And the same thing applies to business decisions.

To the degree we can encourage this cooperation, to the degree we can encourage their students to come here to the United States and vice versa, I think it will be a tremendous advantage to us.

Senator ROTH. Let me just make a couple comments and then we'll proceed to you, Mr. Andrews. As you might have gathered from my earlier questions, I'm a strong believer that it is valuable to this country's long-term interest to help train and educate foreign nationals. Going back to your question about the ambassador, you heard that at my suggestion the Secretary of State did send out a letter, an instruction, that trade is supposed to be a keen interest of ours and they would be judged accordingly.

I have a couple of suggestions to make in this area. Where you have cases like this one in Saudi Arabia and the medical hospital, I'd be interested in hearing about it. I want to make certain the facts are accurate because I don't want to raise false problems. But that seems to me exactly contrary to the instruction. If the host country has made that decision, I don't know why we shouldn't help them carry out that decision. Certainly we shouldn't go to the other extreme. So I would urge the chamber and business people in general to help monitor and give us these cases so as they come up—you know, we're changing direction and there has been an adversarial relationship. There's been what some people call the "Marshallitis" approach in the past where we have been trying to help other people sell rather than help our people sell. It's going to take time to retrain and get people thinking along these different lines. So that kind of incident substantiating could be very helpful.

Mr. Andrews.

STATEMENT OF GEORGE H. ANDREWS, VICE PRESIDENT, MORRISON-KNUDSEN, BOISE, IDAHO

Mr. ANDREWS. I will try to be very brief and I certainly don't want to plow acreage that's been plowed before.

As you know, the American engineering construction industry years back did very well in the world. We competed and we competed well. We were competing against the other nations where everybody was sort of using the same ground rules. We were using the same specifications. We were using the same methodology and really it was sort of he who came in with the best price got the job. We and many other companies in the United States were extremely successful in doing this.

But 10 years ago things began to change. In short, in large projects throughout the world a new ingredient has been added for the constructor and that is that we now have to search, find and bring financing to the job—not only engineering and construction, but we've got to bring financing.

Now we have been able to do this and do this successfully in a few cases through utilizing the Eximbank and a blending of export-import banking direct lending authorities and guarantees for commercial banking and so forth. However, let's face it, the Eximbank right now is having a tremendous amount of problems. They are trying to stay on a self-sustaining basis. They have very little funds available. They have had to raise their interest rates to the point now that they are anywhere from two, three, and four points higher than our Japanese or French competitors. They ask for much shorter terms than normally our competitors would give them. So in actuality, as far as Government help on getting these construction projects, we're not getting very much on it.

Now I don't want you to think that Morrison-Knudsen is going out of business along with all these other companies because we're not. In fact, we are doing quite well right now. But what we have done is we have gone more or less to the private sector. Large private companies are financing large projects throughout the world, like the Exxons and so forth, to develop megabuck projects, and throught this we have been successful and hopefully will continue to be successful. But I do think that our Government is going to have to take a real hard look at what they can do to increase our competitive capability in competing in the engineering construction market overseas.

As you well know, the construction industry is one that has always operated in the arena of competition and we understand competition and we welcome competition, but we would like to be able to compete on an equal basis in the world marketplace. And really, right now, as I look around, trying to finance a project for Morrison-Knudsen Co. and I look for Eximbank help or any other type of help, it's not there.

Another thing that's got to be realized—and I'm sure you know it, sir—when Morrison-Knudsen loses a contract or when Bechtel loses a contract for something overseas, it's not only us that loses the contract. It's Caterpillar Tractor who loses a big chunk of business and General Electric loses a big chunk of business, and all the suppliers people who furnish the materials, American concerns. They lose the business.

I can't give you the specific figures. If you want them I'll get them for you, but we figured out for every employee we put overseas the Government gets back about $160,000 a year through taxes from either the individual or the corporation, and another figure, for whatever it might be worth, we are fighting for relief in the tax area—we figure for every American we put to work overseas, there's about eight people employed back here making things to keep him working over there.

So even though it may be heresy to think of some kind of a governmental support—God knows I'm against it—but it may have to be faced up to because maybe for a minimum amount of dollars on

PREPARED STATEMENT OF GEORGE H. ANDREWS

I AM GEORGE H. ANDREWS, VICE PRESIDENT OF MORRISON-KNUDSEN COMPANY, INC. AND I AM PLEASED TO BE ABLE TO PRESENT A FEW THOUGHTS ON HOW THE U.S. ENGINEERING AND CONSTRUCTION INDUSTRY CAN BETTER ASSIST AND PARTICIPATE IN THOSE INFRA-STRUCTURE AND DEVELOPMENTAL PROJECTS SO VITAL FOR FORMING THE BASE TO ENHANCE THE PRODUCTIVITY OF DEVELOPING NATIONS. OURS IS A SERVICE INDUSTRY WHICH MEANS THAT GENERALLY WE PERFORM ON A PROJECT BY PROJECT BASIS, STARTING AT THE BEGINNING, BRINGING IT TO REALIZATION, AND THEN LEAVING.

AS A RESULT OF THE WORK WE HAVE DONE OVERSEAS FOR THE PAST 70 YEARS IN 75 COUNTRIES, OUR COMPANY, AS ONLY AN EXAMPLE OF MANY OTHER U.S. COMPANIES, HAS ATTAINED A REPUTATION OF LEADERSHIP FOR MAJOR CONSTRUCTION PROJECTS WORLDWIDE, AS WELL AS A REPUTATION FOR OUTSTANDING RESPONSIVE ENGINEERING. WE, ALONG WITH SOME OF OUR U.S. COLLEAGUES, ARE CONSIDERED TO BE THE MAJOR MULTINATIONAL ENGINEERING CONSTRUCTION COMPANIES IN THE WORLD, AND FOR MANY YEARS WE HAVE PARTICIPATED IN THE BUILDING OF INFRASTRUCTURE AND PRODUCTION PROJECTS FOR MANY OF THE DEVELOPING COUNTRIES.

INITIALLY, OUR EFFORTS WERE CONCENTRATED IN PARTICIPATING IN THE WORLD MARKETPLACE ON LARGE COST INTENSIVE CONSTRUCTION PROJECTS. THIS WAS DONE ON A PURELY COMPETITIVE BASIS AGAINST WORLWIDE COMPETITION WHERE WE AND OTHER COUNTRIES WERE ALL COMPETING ON THE SAME BASIS AND SUCCESS WAS

DIRECTLY RELATED TO LOWEST PRICE. THESE PROJECTS WERE ALREADY FINANCED AND WE WERE ALL OPERATING AGAINST THE SAME GROUND RULES, AGAINST THE SAME SPECIFICATIONS, AND UNDER THE SAME CONTRACTURAL REQUIREMENTS. IN THE MAIN, THESE WERE LARGE INFRASTRUCTURE AND INDUSTRIAL PROJECTS FOR DEVELOPING NATIONS THAT HAD A VARIOUS BLENDING OF FINANCING WITH A CERTAIN AMOUNT OF DIRECT U.S. ASSISTANCE THROUGH SUCH PROGRAMS AS RECONSTRUCTION FINANCING, AID, MILITARY FUNDING, ETC.

BUT ABOUT TEN YEARS AGO THESE TYPES OF PROJECTS BEGAN TO DRY UP. THE U.S. FOREIGN ASSISTANCE ELEMENT WAS NO LONGER AVAILABLE TO THESE NATIONS TO SUPPORT LARGE PROJECTS. SO THEN, A NEW INGREDIENT WAS ADDED TO THE FORMULA FOR COMPETING FOR FOREIGN WORK. WE NOT ONLY HAD TO BRING OUR ENGINEERING AND CONSTRUCTION TALENTS TO THE TABLE, BUT WE HAD TO BRING FINANCING.

IN ORDER TO PARTICIPATE IN INTERNATIONAL PROJECTS THESE DAYS, WE NOT ONLY HAVE TO BE COMPETITIVE IN CONSTRUCTION AND ENGINEERING, BUT ALSO COMPETITIVE IN BRINGING A FINANCIAL PACKAGE TO THE PROJECT THAT IS SATISFACTORY TO THE CLIENT. WE HAVE BEEN ABLE TO DO THIS IN A FEW CASES UTILIZING A BLENDING OF EXIMBANK FUNDING AND EXIM GUARANTEED COMMERCIAL CREDIT, BUT THESE OPPORTUNITIES ARE DRYING UP AS WELL, PRIMARILY BECAUSE WE ARE UNABLE TO DEVELOP COMPETITIVE FUNDING PACKAGES FOR POTENTIAL CLIENTS. THERE IS NO DOUBT WE CAN COMPETE ON CONSTRUCTION, BUT WHEN IT COMES TO ROUNDING OUT PROJECT FINANCE, WE RUN UP AGAINST OUR COMPETITORS, SUCH AS THE FRENCH AND JAPANESE WHO CAN GIVE THE CLIENT MUCH LOWER RATES AND LONGER TERMS. NEEDLESS TO SAY, "MONEY TALKS". THE OLD DAYS OF EVERYONE COMPETING AGAINST A STANDARD SET OF RULES FOR EQUIVALENT PRODUCT ARE GONE. IF THEY CAN GIVE THE CLIENT SOMETHING ALMOST AS GOOD BUT A LOT CHEAPER, THE CLIENT WILL TAKE IT, ESPECIALLY IF HE CAN PAY

IT BACK OVER A LONGER PERIOD WITH INFLATED FUNDS. YOU ALL REALIZE THAT THE ONLY VEHICLE THAT WE HAVE IN THE U.S. FOR FINANCIAL SUPPORT FOR MAJOR PROJECTS AT THIS TIME IS THE EXIMBANK, ALONG WITH A BLENDING OF COMMERCIAL SOURCES. HOWEVER, WE ALL KNOW THE PROBLEM EXIMBANK IS FACING WITH THEIR REDUCED DIRECT LENDING AUTHORITY AND IN REALITY, HOW FAR CAN THEY GO TOWARD PROVIDING COMPETITIVE FINANCING FOR A MAJOR COST INTENSIVE PROJECT?

OVER THE PAST COUPLE OF YEARS, WE HAVE REQUESTED EXIMBANK FINANCING FOR VARIOUS PROJECTS AND THEY HAVE REALLY TRIED TO BE HELPFUL. HOWEVER, IN ORDER TO TRY TO REMAIN SELF-SUSTAINING AND MINIMIZE THEIR OUTGO, THEY HAVE HAD TO RAISE THEIR INTEREST RATES SO THAT THEY ARE STILL 2-3-4- POINTS OVER THE FOREIGN COMPETITORS. AS A RESULT, THE CLIENT GOES ELSEWHERE. AS I SEE IT, THE ONLY WAY THE EXIMBANK IS GOING TO BE ABLE TO ASSIST AMERICAN BUSINESS IN THE FUTURE IS TO HAVE THE AUTHORITY TO INCREASE ITS DIRECT LENDING AUTHORITIES AS WELL AS DEVELOP COMPETITIVE RATES AND TERMS, EVEN IF THERE HAS TO BE AN INFUSION OF FUNDS THROUGH APPROPRIATIONS OR A BLENDING OF OTHER FUNDS, SUCH AS FOREIGN ASSISTANCE. IF THE USE OF OTHER GOVERNMENT FUNDS CAN ASSIST IN BRINGING DOWN EXIMBANK RATES AND INCREASE THEIR GUARANTEES TO THE PRIVATE LENDING SECTOR, IT IS PERHAPS THE ONLY WAY THEY WILL BE ABLE TO EFFECTIVELY STAY IN BUSINESS AND ALSO GIVE US THE ASSISTANCE WE NEED.

ANOTHER THING THAT WE NEED IS SOME TYPE OF SMALL GRANT OR "SEED MONEY" TO FINANCE FEASIBILITY AND ENGINEERING STUDIES FOR MANY FOREIGN CLIENTS AS A MEANS TO BE IN A BETTER POSITION TO DETERMINE THEIR FOLLOW-ON ENGINEERING AND CONSTRUCTION NEEDS. THE ONLY AVAILABLE FUNDS IN THIS AREA ARE A SMALL \$4-5 MILLION AMOUNT THAT IS INVESTED IN THE TRADE AND DEVELOPMENT PROGRAM: THIS IS A PEANUT AMOUNT AND NEEDLESS TO SAY, IT HAS NOT BEEN TOO HELPFUL. I KNOW OF ONE SPECIFIC MINING PROJECT THAT WE ARE FOLLOWING NOW IN TUNISIA WHERE THE CLIENT

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HAS REQUESTED THAT WE FIND A METHOD OF FUNDING FOR THE FEASIBILITY STUDY WITH A VIEW TOWARD FINALIZING A CONTRACT. EXCEPT FOR THE TDP THERE IS NO PLACE WE CAN COME UP WITH THIS ASSISTANCE TYPE FINANCING. EXIMBANK DOES NOT FUND FEASIBILITY STUDIES. THE TRADE AND DEVELOPMENT PROGRAM HAS REALLY NOT GOTTEN ITSELF OFF THE GROUND AND CANNOT COPE WITH ITS MANY REQUIREMENTS. AS A RESULT, THE CLIENT SAYS "WE DO NOT UNDERSTAND. THE FRENCH SAY THAT THEY WILL GIVE US A FEASIBILITY AND ENGINEERING STUDY COMPLETELY FINANCED BY THEM (THE FRENCH) IN ORDER TO PROCEED WITH FINALIZING A CONTRACT WITH THEM (AGAIN, THE FRENCH)".

IN VIEW OF THE EMERGING U.S. POLICY TO ENCOURAGE THE GROWTH OF FREE MARKET ECONOMIES OVERSEAS, IT WOULD APPEAR THAT THE U.S. AID AND FOREIGN ASSISTANCE PROGRAMS SHOULD BE MORE POINTED IN THE DIRECTION OF REALIZING SPECIFIC PROJECTS IN ORDER TO DEVELOP AN INFRASTRUCTURE AND INDUSTRIAL BASE. THEN PRIVATE SECTOR INVOLVEMENT HAS SOMETHING UPON WHICH TO BUILD.

IN LIGHT OF THE ABOVE, I DO NOT WANT YOU TO THINK THAT MORRISON-KNUDSEN AND OTHER U.S. CONSTRUCTION COMPANIES ARE GOING OUT OF BUSINESS IN THE OVERSEAS AREAS. WE ARE NOT. WE ARE CONTINUING TO DO A CONSIDERABLE AMOUNT OF WORK IN THESE AREAS, BUT WE ARE DOING THIS MAINLY THROUGH PRIVATE FINANCING AND THROUGH NEW TECHNOLOGIES THAT WE HAVE DEVELOPED. BUT, AGAIN I REITERATE THAT OUR FOREIGN COMPETITORS ARE BREATHING DOWN OUR NECKS VERY HARD FOR THIS PRIVATE SECTOR WORK AS WELL, MAINLY THROUGH THEIR USE OF CONCESSIONARY FINANCING.

IN CONCLUSION, I BELIEVE THAT OUR GOVERNMENT WILL NOW BE FORCED TO TAKE A VERY HARD LOOK AT WHAT ACTIONS IT CAN TAKE, NOT ONLY IN THE FOREIGN ASSISTANCE AREA, BUT ACROSS THE BOARD IN ORDER TO PUT THE AMERICAN CONSTRUCTION INDUSTRY ON AN EQUAL FOOTING WITH OUR FOREIGN COMPETITORS. OUR INDUSTRY IS ONE THAT HAS BEEN DEVELOPED AND OPERATES IN THE ARENA OF COMPETITION; WE ARE USED TO IT AND WE WELCOME IT. ALSO, I EMPHASIZE THAT WE ARE IN NO WAY LOOKING FOR A HANDOUT OR AN UNDUE ADVANTAGE. WE JUST WANT TO BE ABLE TO COMPETE ON AN EQUAL BASIS IN THE WORLD MARKETPLACE.

Senator ROTH. Well, let me comment on what you said. I think, as you probably gathered from my earlier remarks, this country, both at the negotiating table and through its policies, has to try to create an environment where American business can compete. I would now, however, not want to mislead you that Government can be the total solution here because, frankly, we, as you well know, have critical budgetary problems and there isn't going to be a lot of new money flowing either in foreign aid or through some of the other programs.

In order to make as strong a case as we can make, I would like to urge you people—because the chamber was extraordinarily helpful 2 or 3 years ago when a group of us went to the Orient to discuss some of the disincentives and incentives of the export of American-made products—that you give some hard thought as to how we can better meet the competition in the Third World.

In doing so, I would urge you to—it's always very easy to say, well, we've got to meet the competition and you've got to have so much money, and yet we don't have it. So keep in mind what's politically feasible or we're all going through an exercise of futility.

I think the important thing that's been shown by the President in his speech and by the fact we're having these hearings is that we think we do have to change our policies and I see a tremendous opportunity in the Third World countries, and we do have to have some aggressive new policies. How we achieve that is something we're all groping for and those of you who are on the frontline, if you want to call it that, can be most helpful. Again, I do say sometimes people from the outside become too theoretical. As I say, we want to look at what we can accomplish politically and, of course, most importantly, it's got to be done with a minimum of funds because the money just is not available today as you know.

Mr. GIBSON. Mr. Chairman, in that regard, it seems to me there are two things we might leave with you. These are three points that were made at our committee last week. One is that when we talk about mixed credits utilizing U.S. aid funds, it is very cost-effective because those funds are in the budget anyway. We are not asking for new money.

There are two other points. Certainly, we appreciated your input and assistance in getting that excellent mailogram out or aerogram from Secretary of State Haig to all the American Ambassadors and the world. I think that will be very helpful. We passed a resolution at our committee hearing, our good chairman here, at which we said we thought such a similar communication should go out to all the AID mission directors to try to give them some instruction that they ought to cooperate with American business when they arrive on the scene, and then one by the Treasury Secretary to the U.S. directors of the World Bank, the Inter-American Bank and the Asia Bank where we have not had very good communications between those.

So I think communications like that which don't cost a thing would set the stage for closer cooperation between business and Government and quasi-government.

Senator ROTH. We'll look into each of those. As a matter of fact, if you will submit the resolution, we will put it in the record.

Mr. GIBSON. Thank you. The resolution is included in my prepared statement.

Senator ROTH. Well, it's almost 1 o'clock so we will not ask further questions except, again, to request your thinking and your ideas on this area. As you heard me say, I intend to follow through and hold additional hearings at a later date so hopefully there's progress made. In the meantime, I urge you not only to let us know but the people in the executive branch. I appreciate very much all of you being here today.

The subcommittee stands adjourned.

[Whereupon, at 12:50 p.m., the subcommittee adjourned, subject to the call of the Chair.]

[The following information was subsequently supplied for the record by Senator Roth:]

AID AND THE TRADE WAR

(By John K. Wilhelm)

INTRODUCTION

The United States is engaged in an industrial trade war whose major arena is the Third World. That war will expand and continue because it is in the interest of our Organization for Economic Cooperation and Development (OECD) competitor governments and their Third World counterpart governments to continue it. U.S. policy has failed to perceive that governments, not corporations, are the prime players in almost all major economic transactions in the Third World, and they use all weapons available to them. The failure of the U.S. government to fight for its industrial markets is resulting in major long-term losses.

The aid budgets of our competitor governments are an important weapon in this war. Use of aid budgets to pursue long- and short-term trade, investment, and financial advantages is expanding rapidly. The U.S. has responded by cutting EXIM bank funds and leaving unchanged the policies governing AID which effectively eliminate any significant use of funds to support U.S. trade, industry and employment.

If the United States wishes to participate significantly in the Third World markets, where the majority of future economic growth is to take place, it must develop an industrial policy similar to its agricultural policy. It will have to incorporate aid policy with trade, domestic and overseas investment, and foreign policy. Impact upon the economy of the United States will have to become an important measure of the success of the AID program.

PART ONE: THE NATURE OF THE BATTLEGROUND

It is interesting that the United States, which now clearly supports a strong defense and armaments policy in the face of the Soviet challenge is basically responding to an incipient trade war with unilateral disarmament. As in the military case, the "anti" trade support argument relies heavily for its success upon a substantial behavioral change in our adversaries—change which they do not see in their interest. In anticipation of our success in jawboning others into abandonment of their successful attacks on our markets, we have pruned our export supports to the core and retained an aid policy which has virtually no export orientation, thus leaving few defenses against our determined adversaries.

Yet, the evidence is quite clear that our OECD trading partners intend to step up aggressive promotion of their exports. The OECD "Gentlemen's Agreement" of five years ago was the result of a U.S. initiative to limit export subsidies. It has failed in part because of subsidy techniques which were not covered by the Gentlemen's Agreement, particularly mixed and joint financing, which offer great flexibility through blending aid funds with others to reduce effective rates.

The Gentlemen's Agreement and its effective demise are illustrative of a U.S. refusal to face up to two very important facts: (1) Export subsidies are in the national interest of many of the OECD powers (and others as well); and , (2) Legalistic remedies such as the Gentlemen's Agreement are easily circumvented by administrative procedures where it is in the national interest to do so. No legalistic formula can bottle up the totality of financial instrumentalities available to modern governments.

Our competition has defined the terms of combat. The French have been very aggressive for some years. The Japanese, Canadians, British, Dutch, and Germans have all declared that they intend to step up their export promotion efforts, citing mixed and joint financing as being among the instruments. That is not remarkable in view of the profound domestic effects these countries experience when their currencies weaken as they are now doing. If they add strong export promotion to the price advantage of their weakened currencies, they have significant opportunities to penetrate and expend markets, alleviate domestic unemployment and rejuvenate their currencies. Are we going to talk them out of that?

The long-term implications of our trade and aid policy are serious. Markets are being lost which would be ours if we had true competition. They would provide work for American labor and industry for many years. they would generate some of the revenues needed for the expansion and modernization of U.S. industry and contribute to tax revenues of government at all levels. They would create work in our most efficient and highest paying industries. In the absence of these jobs, labor will be forced to seek less productive employment.

The United States is in serious danger of falling victim to some very damaging notions. Among them is the view that support of U.S. industry abroad is largess for "fat cats." This ignores the obvious. U.S. industry is our national patrimony, it is where we earn our income and create our wealth. We should not let the politics of envy obscrue that point. Europeans and Japanese understand it well. Support of their industry, especially the modern high productivity sector, is a matter of high national concern and policy. Whether or not a few fat cats make some dollars is a trivial if not irrelevant point. Fat cats do well either way. The question is, how is the national economy doing.

Opponents of export supports argue that in a free international economy export subsidies such as tax rebates to exporters, cut rate credit, government subsidized promotion programs and other devices to stimulate exports are wasteful and leave all exporters worse off. They argue that our objective should be to totally eliminate all export subsidies by all governments. That is our current policy with the leading industrial countries in the OECD.

But the essential characteristic of modern international markets is government participation. The extent of government involvement on the part of buyers and sellers varies. Within the OECD countries there is still a good deal of private commercial competition. The elimination of most export subsidies among the OECD countries may be an attainable goal. It would surely be mutually beneficial. German subsidies to the U.S., U.S. subsidies to Japan, etc., are really difficult to justify in most instances provided markets can be developed elsewhere. Their elimination would be a valid policy objective.

But once we leave the OECD countries the situation becomes very murky. In the case of the East Block countries all transactions involve governments and therefore either directly or indirectly involve other elements of the national policies of the participating governments. There are no "purely commercial" transactions between East and West Germany.

While is it tempting to argue that the OECD countries should eliminate export subsidies to the COMECON countries, as a practical matter, the best that can be realistically expected is a recognition that mutual restraint is in the general interest of all of the OECD countries.

The great free for all is in the Third World, where despite high oil prices etc., growth has moved along at a brisk 7 percent over the last decade. That is where the vital new industrial economies are being built and where the rewards are great for those who are in on the ground floor. It is also where the Europeans and Japanese are trying to nail down secure sources of energy and raw materials to sustain their economies.

Those who watch such matters know that the export credit subsidy war has been going on in the Third World for several years. After all, in 1979 France alone spent approximately $2 billion in export supports, a great deal of which was in the Third World. That is only what was on the books. Moreover, Germany, the United Kingdom, Japan, and Canada, among others, have officially advised the world of their intent to expand the use of "mixed" and "parallel" credits to support exports. The national interest of both buyers and sellers generally supports the trend, as does the context of the "market."

In 1979, the Third World purchased 36.3 percent of all U.S. exports—more than Japan (9.7 percent) and European NATO (24.5 percent) combined. It accounted for 46 percent of all U.S. imports. Even with OPEC netted out, it still accounted for 20.3

percent of total U.S. imports versus 17.2 percent from European NATO and 12.7 percent for Japan. It is folly to leave such markets unattended.[1]

The central feature of commerce in the Third World is that in the vast majority of the larger transactions the LDC government is a participant. A large and growing number of the OECD governments of exporting firms are also participants.

In effect, this is not a commercial arena, it is a marketplace where national, industrial, agricultural, military, technological, financial, and political policies of governments seek to accommodate one another. Price, quality of product, and timeliness of delivery are only elements of the decision. To that must be added concessional credit, extended repayment times, political support of one sort or another, willingness to supply arms, government promotional efforts, off-take agreements and whatever else there is in the bilateral relationship which either government can bring to bear on the transaction.

Under such circumstances it is exceedingly difficult and often impossible for a private U.S. firm, which does not have government support, to compete successfully.

INCENTIVES FOR THE COMPETITION

The U.S. argues for international free trade and an elimination of subsidies. In effect, this policy, if implemented, would give a de facto advantage to the status quo market positions because it would minimize promotional opportunities for those wishing to penetrate new markets. But such a policy is unrealistic. Our competitors are attempting to upset the status quo for a number of good reasons.

A. Domestic employment policy

Domestic employment plays an important role in the industrial policy of most OECD countries. Some industries are government owned, others are privately owned and have a commanding position in the national economy. Either way, there is a strong incentive to keep them operating as close to capacity as possible. Steel is a good example. Shipbuilding is another. Export subsidies are a convenient way to accomplish certain employment goals.

B. Productivity, scale, and technological advance

None of our OECD competitors has a domestic market approaching the size of the U.S. market. Yet they too wish to benefit from the higher productivity and income in the high technology industries. Moreover, they view the aggressive pursuit of new technologies as an imperative for their future wellbeing. But because markets are smaller than ours, they must often look to secure overseas markets to generate sufficient demand to justify high research and development costs and large capital investments. The economies realized by spreading such costs over a larger market based upon exports may easily offest the cost of the export subsidy. Aircraft, nuclear reactors, and certain types of capital equipment all fall into these categories. Export subsidies are an important tool for the development of such markets.

C. Market penetration

Export subsidies are a convenient way of penetrating new markets. It can be argued that private firms should do this out of their own resources. But that ignores the thinner capital resources (compared to established U.S. firms) of many firms in Europe and Japan. Moreover, a private market development effort yields no political benefit to the government of the exporting firm. A government export credit or aid grant does.

D. Stable and secure sources of oil and raw materials

The oil embargo of 1973 intensified the long-standing desire of the Europeans and the Japanses to secure reliable sources of oil and raw materials. Concessional credits are one of the means for doing that.

The "discount" involved in a concessional loan for mining or drilling equipment may be seen as a small price to pay for security.

E. Foreign exchange earnings

Certain types of exports, particularly capital goods, not only earn the foreign exchange involved in their original purchase, they also imply purchases of associated equipment and spare parts far into the future. What may appear as a handsome discount on credit terms may be more than offset by the assured long-term cash market which it creates. Secure markets to earn foreign exchange are an important

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[1] Statistics: "Trade Patterns of the West, 1979" U.S. Department of State, Bureau of Public Affairs, Washington, D.C. Special Report No. 74, July 17, 1980.

consideration to governments of countries which are highly dependent upon imported fuel and raw materials.

F. Political and economic influence

The maintenance of influence in certain countries, particularly former colonies is a further incentive for the maintenance of a strong commercial presence sustained by concessional export credits. The Lome countries are a good example.

G. The zero net cost factor

Finally, it is very important to realize that the granting of concessional credits to support exports may not be viewed as a real net cost. All OECD governments are aid donors and have a budget for that purpose. The use of aid credits in association with EXIM or commercial credits does not result in an increase in the overall national budget. Neither does an aid project with export promotional qualities. The aid budget is there anyway. Indeed, use of a portion of the foreign aid budget to support the national employment and industrial policy may be needed to sustain a constituency for the foreign assistance budget to begin with.

Needless to say, several or all of these considerations may and often do combine to influence decisions on whether or not to grant credits on a mixed or parallel basis or undertake an aid project.

LOOPHOLES IN THE SYSTEM

A large portion of the export subsidies of our OECD competitors goes unnoticed. The Gentlemen's Agreement established what are called "consensus rates" of interest to be charged for normal EXIM bank type credit. They are based upon a formula which takes into account the per capita national income of the borrower. Under the terms of the agreement regular export credits below consensus rates are proscribed.

But there is a loophole. Export credits associated with concessional aid credits are not prohibited so long as the EXIM type portion of the loan is at the consensus rate. But, the effective rate of the loan on the total project is below the consensus rate. The mixing of concessional loan funds in this manner is called "mixed financing." A similar "mixing" of aid funds with commercial lending is called "parallel" financing. The latter goes fully unreported under the Gentlemen's Agreement.

The loophole was quickly seized upon by France and others. It is one thing to agree on rates for routine export financing, it is quite another to agree on the use of aid funds. The latter include considerations of great complexity and touch materially upon a large array of issues which entail the national interest.

PART TWO

In an effort to shore up the faltering Gentlemen's Agreement, a further accord was achieved. Where a mixed credit is less than 25 percent concessional, i.e., it has a grant element less than 25 percent, it is no longer considered aid. It is now an export credit. It was agreed that countries would give prior notification of offers of such credits to the OECD in order that potential competition could counter with bids of their own. Parallel credits, i.e., those where aid funds are mixed with loans of commercial banks, are still not reported to the OECD regardless of the degree of concessionality.

What emerges from all of these definitions and agreements is that the aid or foreign assistance policy of most OECD governments is an integral part of their trade and export policy which in turn is part of their national employment and industrial policy. That is one of the reasons for the Third World becoming the battleground in the trade war. The aid budget is the most flexible and effective weapon in the war. Moreover, it need not entail new budgetary appropriations.

The trading advantages which once were achieved with dumping and multiple exchange rates (the pariahs of the 1930s and 40s) are now accomplished with far greater precision on a commodity by commodity, and transaction by transaction basis. Floating exchange rates and progressively lower tariffs among the OECD countries have narrowed the range where countries can seek special trading advantages. Per force, they must go to the Third World and use aid concessional funds. That is the unregulated twilight zone.

To date, U.S. policymakers have focused on the lending policies of the traditional export financing institutions such as the EXIM bank. There banks lend at rates below the commercial market, but usually do not technically subsidize their lending rates with appropriated funds. At least theoretically, it is possible to reach a workable accord on their lending practices.

But aid programs and mixed and parallel financing practices open a Pandora's box of domestic and foreign policy considerations. To whom should aid be given, what kind of aid is appropriate, what terms are appropriate, is the aid consistent with the donor's domestic industrial policy, is it consistent with the donor's trade policy, does it serve donor country cultural and political interests, is the aid such as to encourage a sufficient constituency in the donor country to assure that parliament will continue to vote for aid funds?

When a parallel credit is given, is it unfair competition or a legitimate stretching of aid funds to maximize the resources put into a particular country? For instance, it can be argued that in the absence of some parallel aid funding a certain project would not be able to secure sufficient commercial financing. The relatively small loan then makes a much larger project viable. Surely the recipient is better off, and so is the donor. Is that unfair competition or maximizing the input of needed resources into the economy of a developing country? The debate could go on for a longtime and be inconclusive.

The case is similar with mixed financing. If an aid loan pays for docking facilities and an EXIM bank loan finances the fishing boats, is that unfair competition, or are these just two separate loans? Moreover, we must ask ourselves, can or should such transactions be controlled?

The point is that these loan practices occur in an intertwined financial, political, and economic continuum. Many masters are served regardless of the stated purpose of the transaction.

The analogy would be U.S. agricultural policy which resembles the industrial policies of some of our OECD competitors. The U.S. actively subsidizes farmers with loans, price supports, and an impressive overseas marketing effort. What cannot be sold at market prices, i.e., those prices which the Department of Agriculture deems appropriate, is sold on a concessional basis (PL 480 Title I), or given away (PL 480 Titles II and III). These exports are the end product of U.S. domestic agricultural policy which has powerful constituencies. The manner in which the transactions take place is deeply intwined in domestic agricultural policy, foreign policy, aid policy, and trade policy. For instance, when the U.S. insists upon a country importing its usual market requirements on a commercial basis, does the granting of a subsequent PL 480 loan on concessional terms make the entire agricultural program in the importing country a parallel market transaction or are these just two separate transactions? Is it unfair if the concessional element of the total is less than 25 percent? To treat U.S. agricultural exports as a pure export policy issue is to ignore a very large iceberg. The same is true of the industrial exports of many of our OECD competitors.

The question that U.S. policymakers will be forced to grapple with as the export war heats up is this: Should the U.S. attempt to convince the other OECD countries to abandon their successful industrial policies (which resemble our highly successful agricultural policy), or should the U.S. develop and implement an industrial policy of its own in which its aid programs play an important role?

An examination of our competitors market behavior is in order.

THE COMPETITION

The Japanese have one of the most developed industrial policies, and it has been very fruitful. Through skillful channeling of low cost loans, insurance, and government assistance in overseas market development, industries are developed and upgraded. The emphasis is on those industries which increase productivity. In addition to domestic financial support, Japan also has an active policy of phasing out lower productivity industries and supporting their development by Japanese investors in selected LDC's. The products of those investments are then exported to Japan.

Japanese trade, foreign investment, and aid policies are an integral part of the overall industrial policy. Export financing is available for products which the government is encouraging, i.e., high productivity. Imports of low productivity components of overseas Japanese investments are favored. Mixed and parallel credits facilitate Japanese market penetration. The Japanese aid program stakes out lucrative markets for select industries. For instance, Japan has given priority to public utilities, communications, power generation and distribution systems. Japanese Official Development Assistance (ODA) profiles as indicated below.

CATEGORIES OF JAPANESE BILATERAL ODA

[Percent of total]

	1977	1978	1979
Capital projects	74	67	74
Technical cooperation	9	11	11
Nonproject aid	17	22	15

It is important to note that the categories of projects which constitute the majority of Japanese ODA are in areas where subsequent procurement of spare parts and associated equipment on a commercial basis is very high. About 50 percent Japanese ODA is for public utilities, communications, power generation and distribution facilities. Japanese aid projects create lucrative markets for Japanese industry which reach far into the future.[2]

The U.S. finances almost no projects which promise such follow on with its aid program.

Japanese imports of cheap industrial products from LDC's now account for 10 percent of total imports. A good portion of these imports comes from plants built abroad by Japanese as part of the Japanese policy of upgrading domestic productivity by exporting unproductive industries to LDC's.

The U.S. is neutral on foreign investment, neither encouraging nor discouraging it. The U.S. has no policy of phasing out low productivity industries. In fact, as is the case with shoes and textiles, it tends to protect them. The U.S. Overseas Private Investment Corporation (OPIC), which insures U.S. overseas investments, is not allowed to operate in the Middle Income LDC's where the opportunities for investment are most promising.

The Japanese have announced their intention to expand the use of mixed financing to support Japanese exports. That is a logical extension of Japan's domestic industrial policy.

France has been by far the most aggressive among the OECD countries in promoting exports. In fact, many countries cite the need to meet French competition as a major reason for intensifying their own promotional efforts. Like Japan, France has an industrial policy which is intimately associated with her trade, aid, and investment policies.

French support for industries selected for promotion is comprehensive. Low cost loans provide capital, research, and development funds. Guarantees and insurance are available to cover the risks of inflation, currency value fluctuations and nonpayment. French banks are enabled to provide commercial credit on a favorable basis. These credits are often complimented by concessional aid loans and/or EXIM bank type loans.

It is difficult to judge the merits of the lavish open ended support of exports by the French government. In 1979 some 40 percent of all French exports benefited from some type of government support. When we note that in the same year 52.8 percent of total French exports were to other countries in the European Economic Community (EEC) which does not allow concessional credits among member countries, it becomes obvious that the vast majority of French exports to non-EEC countries benefited from one form or another of French government support.

The impact on the French economy in terms of its currency, industrial base, employment and future productivity are unknown. What we do know is that the French economy has performed well by OECD standards. It has benefited from the emphasis on high technology, managed to pay for its energy and other imports, and allowed for the maintenance and expansion of French influence abroad. There is speculation that some export industries have located in France from other countries in order to benefit from French export promotion.

In recent times the French have been criticized for their use of mixed credits, but they have maintained that mixed credits simply stretched their "aid dollar" and are beneficial to both donor and recipient.

In addition, France has been the leader in forming the Lomé convention group consisting of 58 LDC's and the EEC. The Lomé convention provided for intergrated programs of trade, aid, and investment. In 1977, these LDC's sent 43 percent of the

[2] One of the more remarkable elements of U.S. foreign policy is the U.S. willingness to accept increases in Japanese aid as an acceptable substitute for increased defense expenditures.

exports to the EEC and purchased 48 percent of their imports from the Community. France plays a very large role in the Lomé group.

Significantly, France which gives almost twice as much ODA as a percentage of gross national product (GNP) (0.59 percent in 1979) as the other OECD countries has little difficulty sustaining public support. Part of the answer on this phenomenon may be in the recognition by the French electorate that aid is an integral part of national industrial, cultural, political, and employment policy. It is also significant that about 85 percent of French aid is bilateral. Total financial support to developing countries is 1.52 percent of GNP.

By contrast, the U.S. ODA for 1979 was 0.22 percent of the GNP and total financial flows to LDC's constituted 0.79 percent of GNP. Yet, when in 1980, an NBC-NEWS-Harris Survey asked Americans where first to cut the budget, 82 percent favored cutting AID first with only 14 percent opposed. In 1978, 41 percent of respondents favored cuts and 46 percent opposed.

The United Kingdom, as part of the overall retrenchment of economic policy, has caused a marked shift in aid emphasis to support exports and stretch dollars. The UK has announced its intention to absorb cuts in its aid appropriations in the multilateral accounts and shift emphasis to the bilateral accounts. Five percent of UK bilateral aid is to be devoted to helping UK firms to win orders in developing countries where the UK is not currently a donor, or where planned aid allocations are already committed. These Aid Trade Provision (ATP) funds will be offered as mixed credits. Moreover, emphasis in the UK assistance budget has been shifted from agriculture, education, and social infra-structure to large-scale power projects, heavy industry, and transport. By way of example, in 1978, the UK devoted $12 million to the energy sector; in 1979, it was $235 million.

Canada too has announced a shift from multilateral to bilateral assistance. The latter is to be in association with broader involvement of Canadian firms—a better trade-aid interface. Emphasis is to be on parallel and mixed financing of exports.

Germany is moving in the same direction in 1978, Germany provided $56 million in mixed credits, that grew to $338 million in 1979. The German government has announced a policy of making greater use of mixed credits in the future. Other donors are doing likewise.

PART THREE: TRADE IMPLICATIONS OF AID PROJECTS AND TECHNICAL ASSISTANCE

The use of aid programs in support of donor country employment and industrial policy extends far beyond the practices of mixed and parallel financing. For instance, the Japanese aid projects have substantial implications for future Japanese exports. The power generation and distribution projects which account for fully one-half of all Japanese aid projects will stimulate commercial purchases from Japan for spare parts and associated equipment for many years. The same is true for the capital projects of France, the United Kingdom, and others. Moreover, these countries have advised the OECD that they intend to further orient their aid programs toward support of domestic industry in the years to come.

The United States AID programs have a different focus. Especially since 1973, U.S. AID development programs have been strongly oriented toward the poor in the poorest countries. The emphasis has been and remains on a "basic human needs" (BHN) approach. Reduction of hunger and malnutrition, encouragement of family planning, improvement of health care, improvement of small holder agriculture, equity, and enhancement of opportunities for women receive high priority in U.S. programs. Programs from which elites and commercial sectors benefit have been deemphasized. The U.S. has phased out its programs in the "middle income countries" (MICs) and as a matter of policy emphasizes the role of the Multinational Development Banks (MDBs) in those countries.

By way of contrast, other donor countries maintain bilatral programs in the MIC's, where they emphasize projects which stimulate donor country industrial exports and investment in industries which support donor country industrial and employment policy. In the poor countries, other donors have moved their efforts closer to the U.S. approach on BHN, but they continue to support industrial projects and investments which support industry at home. These policies give the industry of other aid donor countries a distinct advantage over U.S. firms. It also prepares for ground floor participation in the new industrial economies of the future. The aid of other donor countries in the industrial and infrastructure sectors of recipient economies prepares markets for donor country exporters which project far into the future. The U.S. does not do this. Even where the Economic Support Funds (ESF) are used, a strong effort is made to have them benefit the rural poor, emphasize primary health, agriculture and generally support BHN.

The table below illustrates the point. Virtually no industrial export opportunities flow from the U.S. programs.

U.S DEVELOPMENT ASSISTANT PROGRAMS, 1979-80

[Percentage allocation by catetgory]

Category	Percent of total	
	1979	1980
Food and nutrition	50	51
Population	15	15
Education and human resources	8	8
Health	11	10
Sahel program	6	6
Other activities	10	10

Perhaps it is because of this perspective that the United States tends to look with favor on aid efforts of other donors. Any loan which has a concessional grant element greater than 25 percent is treated as aid, the U.S. finds it unobjectionable. Yet all of the German mixed credits to date—credits in support of German industry—have had a grant element of more than 25 percent. Indeed, we do not know how much support the industry of our competitors receives in the twilight area between 25 percent concessional financing and what is more properly viewed as aid, i.e., concessionality in the 85 to 100 percent range.

The twilight zone of concessionality is where the lucrative industrial projects of tomorrow's industrial giants, like Brazil, Korea, Mexico, and Taiwan are financed. There is no way U.S. firms can currently compete on projects where other governments promote their industry. There is no way to measure the cost of opportunities lost for future U.S. exports because of the inability of the U.S. to use its aid funds in the same manner as its competitiors.

In the case of technical assistance a similar condition obtains. The United States concentrates heavily upon upgrading the skills of the poor. In the past the U.S. used to do industrial feasibility studies and planning for power grids and air traffic control systems, etc. Such studies gave a strong advantage to U.S. firms and vendors in the execution of the projects which followed. By way of example, the U.S. provided the 20-year master plan for the Bankok Metropolitan Electric Authority (MEA) in Thailand under one of its programs prior to the BHN emphasis. U.S. vendors enjoyed about 40 percent of all MEA procurement. Because the U.S. would not finance the follow-on, 20-year master plan at a cost of some $300,000, the MEA accepted a Japanese offer to do it gratis. U.S. vendors fully expect to lose the MEA market as a result, a loss of $200 to $250 million in U.S. exports over the next 20 years. Similar examples abound.

The U.S. BHN emphasis in technical training stresses the development of agricultural and health skills for service to the poor. Advanced technical training for national decision-makers in developing countries in those fields which would tend to create markets for the U.S. has all but halted. Japan, Germany, the U.K., and others are now filling this void. Where past U.S. training has resulted in a strong technical orientation toward U.S. procurement on the part of today's decision-makers in many developing countries, the decision-makers of tomorrow will more likely be oriented toward our OECD competitors.

It is axiomatic that technicians will have a propensity to purchase from the U.S. if their training is in the U.S. Procedures, technology, language, and a number of less tangible factors all reinforce this propensity. Yet in 1978, there were 3,160 AID sponsored LDC technical students in the U.S., versus 9,528 for the U.K., 4,509 for Germany, and 8,135 for France. Even Belgium and Austria outpaced the U.S., with 4,405 and 3,925 students respectively.

In the area of technical trainees, the U.S. had 3,030 versus 4,959 in the U.K., 26,123 in Germany, and 7,669 in France.

In 1970, the U.S. gave 18,272 fellowships; by 1979, this had dwindled to 7,967. Also in 1979, Japan gave 9,197, the U.K. gave 17,434, and Germany gave 33,260 fellowships.

A review of current technical training programs financed by AID in light of their impact on the future position of the U.S. private sector in recipient countries would be appropriate in view of the long-term efforts of our competitors.

MEASURING THE IMPACT

It is virtually impossible to assess the losses suffered by the U.S. in either dollars or employment. But is certainly significant and growing. With LDC's absorbing fully 36 percent of all U.S. exports in 1979, it is hardly wise to take a casual or theoretical approach to the problem. There is virtually no way to assess the amount of business lost because of mixed or parallel financing. The majority of such transactions goes unreported. Moreover, many U.S. firms don't even bother looking at opportunities where there is reason to believe that competitor governments will intervene.

But it is indisputable that if the French take transportation and communication, the Germans shipping and capital equipment, the Japanese power projects, and who knows where others will specialize, the U.S. will find itself totally locked out of lucrative markets where its firms would have competed successfully on a commercial basis. It is also indisputable that the loss is long-term, not once over.

Nor can one dispute that the U.S. failure to finance feasibility studies or infrastructure planning results in the loss of substantial markets to those who do. A firm which performs a feasible study or project design has a distinct advantage over its competitors for the project itself. French firms have an advantage on projects designed to French specifications. Japanese vendors have an advantage on air traffic control systems designed to Japanese specifications. German trained engineers and technicians will have a propensity to buy German equipment once they have returned home and become project directors.

The extent of the competition to U.S. industry which is financed out of other country aid programs is impossible to assess. Official reports on financing and training are vague, do not have a common terminology or data base, and are closely held by bureaucrats. Moreover, because of the nature of the U.S. aid program, there has been little incentive to examine its export impact, other than the "buy American" element. There is virtually no attempt to assess the implications for U.S. industry in the design and execution of U.S. AID programs.

The condition is not the result of incompetence on the part of the Agency for International Development. It stems instead from the policy of both the legislative and executive branches of the U.S. government since 1973. This is remarkable in view of the erosion of public support which has occurred in recent years. It is all the more remarkable in view of the serious determination of our major industrial competitors to aggressively use their foreign assistance funds to promote their industries' activities in the Third World.

CONCLUSION

It is very unlikely that competitor governments will abandon their industrial policy and its aid link. Clearly then, the U.S. must either be prepared to cede major markets in the Third World for the indefinite future, or it must develop a means to defend the markets which it considers to appropriately belong to its firms. While it is conceivable that a "soft loan window" could be opened at EXIM, that would only be a partial solution. It would address, at least in part, the mixed and parallel credit issues. The export implications of aid projects and technical assistance and training programs would remain untouched. In any event, EXIM bank funding should be enhanced, not diminished.

The U.S. would be well advised, however, to study the interrelationships of the various modalities used by the Japanese and French governments to coordinate all elements of their industrial policy.

For AID this would imply a lifting of the restrictions on the countries where AID may operate, and a tailoring of programs to be more responsive to competition by other foreign governments. In particular, this would imply a capacity to finance mixed and parallel credits, especially in MIC's. The term mixed credit is used here to describe any loan where AID funds are "mixed" with EXIM funds, regardless of the degree of concessionality.

Similarly, AID project programs should be in part oriented toward support of U.S. industries in key sectors of LDC economies. The same applies to technical assistance and training programs.

The British model deemphasizes multilateral aid in favor of bilateral aid. Within the bilateral aid program it specifically reserves funds for support of U.K. industry. A similar approach may prove fruitful for the United States.

This does not argue for abandoning efforts to upgrade small holder agriculture or development of programs to address basic human needs. It does, however, suggest that such programs are more properly conducted by the multilateral organizations and the World Bank group.

Such a shift in orientation would assure the continuation of humanitarian efforts while at the same time forcing bilateral aid resources to support legitimate U.S. economic objectives in its own self-defense.

If the United States is to successfully defend its industrial interest in the Third World, an important parameter for evaluation of AID loans and projects will have to be their impact upon the U.S. international trading position, both short- and long-term.

The present alternative is costly.

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