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No. 2

Mobilizing International Surpluses
for World Development
A WIDER Plan for a Japanese Initiative

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OF THE UNITED NATIONS UNIVERSITY

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Mobilizing international surpluses for world development: A Wider plan for a Japanese initiative

Report of a Study Group of the World Institute for Development Economics Research (WIDER), Helsinki, Finland, of the United Nations University (UNU), Tokyo, Japan

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7 May 1987
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MOBILIZING INTERNATIONAL SURPLUSES FOR WORLD DEVELOPMENT: A WIDER PLAN FOR A JAPANESE INITIATIVE

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PREFACE

1. At an informal meeting of senior officials and academics from 15 developed and developing countries to explore possible areas of mutual interest among medium-sized economies — the "Middle Powers" — held in Helsinki at the World Institute for Development Economics Research (WIDER) on 24—26 March 1986, it was agreed that a research programme for WIDER should include, in its priorities:

> "Measures for the more effective utilization of Japanese current account surpluses in support of developing countries' needs and the possibility of new 'windows' in multilateral institutions' lending, and new instruments in international finance more generally."[1]

2. A first concrete step in this direction was the preparation of a report[2] by a WIDER Study Group on 18 April 1986, consisting of Dr Saburo Okita[3] as Chairman, Dr Arjun K. Sengupta,[4] and myself. We argued that it would be a mistake for Japan to abandon entirely her strategy of export-led growth in response to current pressures for domestic expansion, although there was obvious need for the latter. We proposed that a part of the continuing Japanese surplus be used to finance the deficits of developing countries, and that mechanisms for financial intermediation should be evolved towards this end. We also suggested that the Japanese Government could take the initiative of contributing to the establishment of an international fund for the purpose, an amount equivalent to 0.1 per cent of Japan's GNP, while simultaneously inviting other industrial countries to join:[5]

> "The fund would permit concessions and incentives..... either by subsidizing the interest rate on loans to developing countries or by providing some collateral to ..... private savings institutions ..... which would mobilize private capital flows to developing countries that are **a substantial multiple of the resources available from the fund.**"

3. On 26 November 1986, a five-member Group of Senior Ministers and economists from developed and developing countries, all members of the Board of WIDER, meeting in Helsinki, referred to WIDER's previous Study Group Report and called on Japan and other surplus countries to use their surpluses for world economic development:

> "This surplus is now viewed in a negative light — because it is associated with Japan's export drive and the problems caused in other industrial countries by Japan's supercompetitiveness. Instead, the potential of the surplus for world economic development should be emphasized. Although Japan is in the best position to take the initiative, the principle that surpluses should be put to work for development applies also to other surplus countries, notably Germany. Most of the capital outflow from Japan at present goes to the United States to purchase Treasury bonds, real estate and other assets. A part of

this money could be funnelled to the developing countries; it would make a major contribution to development in Asia and elsewhere and ultimately to world economic growth."[6]

Apart from Dr Okita and myself, the Group consisted of Mr Abdlatif Y. Al-Hamad, Chairman of the Arab Fund for Economic and Social Development, Kuwait, and a former Minister of Finance of Kuwait; The Hon. B. Chidzero, Minister of Finance, Economic Planning and Development of Zimbabwe and Chairman of the Development Committee of the IMF and World Bank; and Dr Pentti Kouri, Professor of International Economics at the New York University and Advisory Director of First Boston International.

4. Calls for the mobilization of international surpluses for development have continued to come from several influential quarters. Mr Barber Conable, President of the World Bank, has expressed hope on several occasions that Japan's massive trade surplus could be mobilized for development assistance.[7] Mr James D. Robinson, III, Chairman and Chief Executive Officer of the American Express Company, has been in the forefront of proposals for "a Japanese equivalent of the Marshall Plan."[8]

5. The present report has resulted from a reconvened meeting in Tokyo during 29 April to 3 May 1987 of WIDER's original Study Group which prepared its first report last April. On this occasion we have elaborated quite specific mechanisms whereby Japan might implement a $125 billion five-year plan, for recycling annually $25 billion of her surplus to developing countries. A Japanese effort of this order of magnitude if matched by other developed countries, could contribute crucially to desired adjustment and development objectives. It is fully in line with measures already announced recently by Japan and can be considered as the beginning of a Japanese Marshall Plan.

6. The Japanese initiative we recommend envisages, recycling annual amounts of $10 billion, through collateralized lending from Japanese commercial banks and the capital market through the medium of a **Japanese Trust Fund,** located in Tokyo and liaising with the World Bank, and governed by a country specific Policy Co-ordination Committee that would help elaborate longer-term policy frameworks for programme and project lending; $10 billion annually through the medium of the **Export Import Bank of Japan,** possibly borrowed against the unutilized guarantee power of the Bank; and $5 billion annually as **borrowings by the International Monetary Fund** from the Japanese capital market, for longer-term balance-of-payments support to low-income countries. We also recommend the setting up of an interest subsidy account for reducing the cost of borrowing by low-income countries, which could be met out of the **increments** to Japanese Official Development Assistance already announced. The executive summary, and conclusions which follow, outline the specific mechanisms more fully.

7. We are in the debt of a large number of persons who have been consulted in the course of preparing this Report and who have given freely of their time. We are especially grateful to Dr. Dragoslav Avramovic, Economic Adviser, Bank of Credit and Commerce International, S.A., Washington D.C., U.S.A.; Mr. Yoh Kurosawa, Deputy President, The Industrial Bank of Japan, Ltd., Tokyo; Professor Koichi Mera of Tsukuba University, Japan; Mr. Tasuku Takagaki, Senior Managing

Director, The Bank of Tokyo, Ltd., Tokyo; and Mr. Frank Vibert, Senior Adviser, Co-Financing Department, World Bank. The economic background to our Report, as elaborated fairly fully in its Analytical and Statistical Appendix, is based upon a valuable Working Paper prepared for WIDER by Dr. Avramovic. Mr. Vibert provided helpful advice on the kinds of recycling mechanisms that would be best adapted to the institutional settings, respectively, of Japan and of the World Bank. The others consulted belong to a Working Group on Perspectives for International Co-operation based in Tokyo and chaired by Dr. Okita, comprising leading members of the Japanese academic, business, and commercial banking communities. We owe a special debt of gratitude to the Secretary of this Working Group, Dr. Shoichi Kobayashi, Senior Economist of the Engineering Consulting Firms Association of Japan (ECFA), who has been our principal point of liaison in the numerous discussions in Tokyo which have helped shape the ideas contained in our Report. The Report itself, of course, remains the responsibility of the members of the WIDER Study Group.

Lal Jayawardena
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REFERENCES AND FOOTNOTES

1 Summary Statement, Meeting on the Role of Middle-sized Economies in the Governance of the World Economy, 24—26 March 1986.

2 Okita, Jayawardena and Sengupta, "The Potential of the Japanese Surplus for World Economic Development" WIDER Study Group Series No. 1, Tokyo, April 1986.

3 Chairman of the Board of WIDER, and of the Institute for Domestic and International Policy Studies, Japan; Chancellor of the International University of Japan, and a former Foreign Minister of Japan.

4 Member, WIDER Advisory Group on International Economic Issues, Executive Director of the International Monetary Fund representing Bhutan, Bangladesh, India, and Sri Lanka.

5 Okita, Jayawardena and Sengupta, **op. cit.** p. 12 — emphasis added.

6 Press Statement, "Japan should take lead in tackling international economic problems", 26 November 1986.

7 Interviews with **The New York Times,** 3 July 1986, and **Nihon Keizai Shinbun,** 1 August 1986.

8 Published in **The New York Times,** 3 May 1986, **International Herald Tribune,** 5 May 1986, and **Financial Times,** 6 October 1986.

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EXECUTIVE SUMMARY

The Study Group arrived at the following conclusions and recommendations:

1. Substantial surpluses on current account are likely to prevail for the next several years among many developed countries, and there is a need for their diversification towards meeting developing country requirements, both on intrinsic grounds, and in the interests of promoting global economic stability.

2. Japan, in particular, should take an initiative to launch a $125 billion five-year plan for resource transfers to developing countries, at an annual rate of $25 billion. Such an initiative is fully in line with the three-year programme already begun by Japan for the period 1987—89; if matched by other developed countries, the joint effort would contribute significantly to world development. Depending on the persistence of Japan's current account surplus, the plan might be extended beyond five years.

3. The ideal mechanism for implementing such a Japanese initiative would be to equip a Japanese Government Agency with an **explicit** government **guarantee** that will enable it to borrow in the domestic capital market on market terms, with resources for an appropriate level of interest subsidy to be provided to it by a suitable reallocation of Japanese Official Development Assistance.

4. In the Japanese context, the following equivalent mechanisms are also available:

(a) Loans raised under the guarantee of a suitable agency, a **Japanese Trust Fund** might be covered by private reinsurance arrangements.

(b) Developing countries might borrow from the Japanese commercial banking system against the collateral of zero coupon bonds purchased from the Japanese or international market, or specially issued by the Japanese Government. The amounts borrowed would be a substantial multiple of the investment needed to buy these bonds, whose face value on maturity will be equivalent to the principal borrowed, thereby fully securing the "bullet" repayment of the principal.

The most appropriate mechanism for this form of borrowing would be through a **Japanese Trust Fund** located in Tokyo and liaising with the World Bank and other regional development banks, for administering the scheme. It could, alternatively, be located within the World Bank, especially if other countries were to join in adding resources to the facility. Its management might be entrusted to a Policy Co-ordination Committee including commercial banks, the Bretton Woods institutions and major developed countries in order to facilitate the evolution of longer-term policy frameworks for lending.

The Trust Fund would purchase the zero coupon bonds from the Japanese Government and from the market, borrow in its own name from the Japanese commercial banking system and from the market, and relend these monies to developing countries at a suitable blended rate.

In order to support a five-year programme of borrowing annually of $10 billion, with a possible extension to ten years, the Trust Fund would ideally need resources from the Japanese Government for the purchase of the bonds to be used as collateral. This would have no immediate net financial impact on the Japanese budget, since the funds would return to the budget when the bonds are purchased. The interest subsidy needed to provide a representative blended rate for lending at below the market rate for borrowing, can be met for the duration of the lending programme, out of the **increment** in Official Development Assistance during the period 1987—1991.

(c) Recourse could be had to the **Export Import Bank of Japan** to step up its co-financing arrangements beyond the recent levels of $2 billion a year, by drawing more substantially on a pool of resources totalling $150 billion annually that are available to the Zaisei-Toyushi — the Government's Fiscal Investment and Loan Programme (FILP). Additional amounts in the region of $10 billion annually for a five-year period, with an extension to ten years if desired, are entirely feasible on this basis.

(d) The Export Import Bank of Japan has an unutilized guarantee power of around $40 billion which could be utilized in a variety of ways for increased transfers to developing countries; the guarantee power itself could be increased either by increasing the Bank's capital or by varying its gearing ratio.

(e) The **International Monetary Fund** should be enabled to borrow in Japan's capital market at the rate of $5 billion annually for the purpose of programme lending to low-income developing countries, under the IMF's Extended Financing Facility. The Japanese Government should provide an interest subsidy to reduce the cost of these funds to the user.

(f) A debt restructuring facility, utilizing market mechanisms, might be established on a Japanese initiative, in order to pave the way for a resumption of lending to debtor countries.

(g) Lending under these programmes might focus on infrastructure development, in addition to normal project and programme lending in support of growth-oriented adjustment programmes.

5. Japan is in a position to aim for a tripling of Official Development Assistance over the period 1985—90.

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THE REPORT

I. The Rationale for Substantial Transfers

1. The developing countries are today in the paradoxical situation of transferring resources **to** the outside world instead of being, as is normal, the net recipients of capital inflows. While in Africa the outflows stem primarily from official debt, in Latin America and Asia they derive from private debt contracted during the decade of the 1970s; the problem has, in varying degree, been aggravated by depressed commodity prices and export earnings. The outflows, running at an annual rate of $30 billion in 1985—86, are projected to continue, in the near future, at least on the same scale, rising to nearly $40 billion in the early 1990s. This outward transfer of $30 billion compares with a resource inflow of a similar magnitude in 1980—81 before the onset of the debt crisis. Altogether, therefore, there has been a turn around of capital flows during the decade of around $60 billion, which developing countries have had to meet by a corresponding compression of imports. As a result, their levels of living, and levels of income and investment, have suffered catastrophically. This is not sustainable.

2. In today's interdependent world economy, the industrial countries too have been caught in a vicious circle, where their exports have also suffered in this process. The $18 billion trade deficit which developing debtor countries ran with industrial countries in 1981, was transformed by 1984 into a $31 billion trade surplus, most of the adjustment coming from a $40 billion reduction in debtor country imports. The United States and the European Communities were particularly hard hit, each experiencing a 30 per cent drop in exports to the debtor countries.[1]

3. What is required, therefore, is the restoration of a virtuous circle whereby substantial resource inflows to developing countries propel both their own economic recovery, and restore an export-led growth impulse to developed economies. The potential for the substantial resource transfer needed to set this virtuous circle in motion has never been greater, with Japan and several European countries, primarily the Federal Republic of Germany, generating current account surpluses in 1986 of the order of US$145 billion per year. These surpluses are likely to decline somewhat from this substantial level, as the appreciation of the currencies of these countries begins to restore balance-of-payments equilibrium. Nevertheless, significantly large surplus positions, and Japan's in particular, are likely to persist for the next several years as a result of a number of factors: the benefit of increased interest and dividend incomes on past surpluses invested in the United States, estimated at $45—70 billion in 1990 as compared with $16 billion in 1986; the time taken for

internal expansion in Europe and Japan to get under way in the generally unfavourable investment climate resulting from currency appreciation; and the time taken to throttle down export-led growth, in favour of domestic demand-led growth.

4. In view of the growing determination in the United States to reduce her trade deficit substantially, a partial diversification of the trade and investment of surplus countries in the direction of developing countries becomes highly desirable. An improvement of the US current account in the range $150—200 billion is widely spoken of as being necessary, if the United States were to return to current account balance by eliminating her present deficit, with a margin to spare for financing the interest payments on her net foreign debt. This turn around is equivalent at least to eight per cent of current world exports, and is bound to have a major deflationary impact on export prices, volumes and activity elsewhere, unless it is matched by a sufficiently large demand expansion either within the economies of the surplus countries, or the developing countries. For developing country demand to increase, their import capacity will have to be enhanced by a sufficiently large recycling of surpluses in their direction.

5. The complementarity between the urgent resource requirements of developing countries for increased investment and growth, and the availability of capacity in developed countries which may otherwise become idle on an unprecedented scale, has never been as striking as it is today. Matching mutual needs is, undeniably, in the mutual interest.[2]

Japan's Role

6. Finding an appropriate mechanism for recycling the current account surplus of Japan to developing countries is particularly important in this context. In the long run, the growth of domestic demand may provide the main stimulus to Japanese growth, but attempts to adjust too quickly and slacken the pace of export growth may only lead to a sharp fall in the growth of the Japanese economy, which will be detrimental to the interests of the world economy as a whole. A more appropriate policy for Japan in the medium term, has to be centred around a sustained stimulus to the growth of domestic demand, without allowing the growth of exports to decline precipitously.

7. An implication of this policy would be the continuation of a substantial current account surplus in absolute terms, at least in the medium run, even if its share as a percentage of GDP comes down. This can be sustained only if this surplus can be absorbed in the international economy, without causing major disruptions or exchange rate instability. If the United States actively pursues a policy of reducing its current account deficit, the only practical way the Japanese current account surplus can be absorbed by the world is through its recycling to developing countries, by allowing their deficits to expand. There is very little prospect of other industrial countries picking up the slack to any substantial degree in the near future, especially as domestic demand growth in industrial countries will take time to affect their payments imbalances. The mutuality of interest between the developed and developing countries in recycling the Japanese surplus to developing countries is thus evident, particularly in the medium term.

II. The Scale and Impact of a Five Year Plan for Substantial Transfers from Japan

8. The preceding account has emphasized both that substantial surpluses on current account are likely to prevail for the next several years among several developed countries, and that there is a need for their diversification towards meeting developing country requirements, both on intrinsic grounds, and in the interests of promoting global economic stability. If the balance of payments outcome for 1986 is taken as illustrative of the magnitude of these surpluses in the future, a situation arises where Japan's surplus is of the order of $90 billion, Germany's surplus of the order of $35 billion, and that of other surplus countries of the order of $20 billion — the latter two categories totalling $55 billion;[3] Japan's surplus is expected to be particularly resilient, and according to available forecasts, will still be in the range of $60—80 billion annually by 1991.[4]

9. In contrast, net financial transfers **from** major developing countries are projected, annually, over the period 1987—89, to be in the region of $30 billion rising in the 1990s to nearly $40 billion.[5] If resource flows to the developing countries have to be restored to the level of the early 1980s when net **inflows** were around $30 billion, it will be necessary to effect financial transfers to them of at least $60—70 billion annually over the next few years. In real terms these amounts would still be considerably below what was available to them in the 1980s, and what would be required by them for achieving a moderate growth in per capita income. A well co-ordinated international economic policy for the orderly development of the world economy, should provide for the **generation** of substantial current account surpluses in industrial countries to facilitate needed resource transfers to developing countries. Instead of that, the recent stance in international policy has been in the direction of **reducing** the current account surpluses of those countries which are capable of generating them through efficient export expansion and high rates of domestic savings.

10. Indeed, policy co-ordination among industrial countries, through G-5 or G-7 consultations, has centred almost entirely around reconciling imbalances only among the industrial countries, through monetary, fiscal and exchange rate policies, so that the surpluses of some of them are matched by deficits in others, leaving very little room for their resources to flow out to non-industrial countries. During 1975—84, the average current account balance of seven major industrial countries was a negligible negative (—0.1) percentage of their combined GDP. During 1985 and 1986, when Japan and Germany had significant current account surpluses (3.7 and 4.4 per cent of GDP for Japan, and 2.1 and 4.0 per cent for Germany), the current account balances for these seven industrial countries as a whole was again a negligible (—0.7 and —0.2) percentage of their combined GDP.[6] Although the transfer of a small fraction of the combined GDP of these industrial countries would have meant a large resource flow as a percentage of the GDP of developing countries, international policy has not been aimed at effecting such a transfer of resources.

11. It is necessary to break out of the confines of this segmented approach to international policy making, and reach out to the entire world economy by allowing international surpluses to flow to those deficit countries which can absorb them most fruitfully. The social

marginal productivity of these resources would be very high in developing countries short of investible resources; what is lacking is an appropriate mechanism for intermediation so that the savings of the surplus countries could be channelled towards productive investment in the deficit developing countries.

12. Japan is well placed today to take the initiative in bringing about such a process of resource transfer. The Chairman of our Group, Dr Saburo Okita, had previously proposed that Japan should slice up an expected **ex ante** annual structural surplus of $60 billion in three ways: $20 billion to be absorbed by domestic expansion, $20 billion to be maintained as the "notional" market-induced component of the surplus, and therefore **automatically** onlent to other countries, both industrial and developing, and $20 billion to be the component recycled to developing countries through deliberate policy action, the current surplus therefore being $40 billion **ex post.** What is now being proposed is a Japanese initiative to launch such a programme of deliberate transfers to developing countries on a somewhat more ambitious scale, namely, of $25 billion annually for five years. This would only meet a part of the requirements of the developing countries; and it constitutes a challenge to other developed countries to match that effort.

13. An amount of $25 billion per year is broadly consistent with the logic of Dr Okita's earlier proposal for setting aside a third of the expected **ex ante** current account surplus for the deliberate transfer of resources to developing countries, because the surplus may well be around $80 billion annually over the next five years. The assumption that Japanese policy should aim at reducing this surplus by about a third through domestic demand expansion, recognizes the need for domestic adjustment in Japan along the lines of the official policies already adopted. However, if they do not produce the intended results, the surpluses available for redeployment would be larger. The motivation behind our proposal is that in such an event, instead of revising Japan's domestic policies and increasing the pace of domestic adjustment, an attempt should be made to increase still further the resources transferred to the developing countries, as an appropriate policy for the deployment of her surplus.

14. Two other aspects of this proposal are worth emphasizing. As mentioned, the third of the **ex ante** surplus — $25 billion — which is to be its market-induced component, will be automatically onlent to other countries, both industrial and developing, reflecting "normal" policy trends and market-related forces. The third that is to be transferred to developing countries **exclusively** — also $25 billion — would be markedly different in character; it would be the result of **deliberate policy action** by Japan in the manner considered most desirable. Taken together, therefore, what is involved is a current account surplus target over the medium-term of around $50 billion annually, the balance being absorbed through domestic expansion. Secondly, the policy determined component of this target for deliberate transfer requires to be cast at least in a five-year framework, both because it would take time to build up the flow, and because, for deliberate policy to be effective, it has to be held on course for a medium-term period which would be five years at a minimum.

15. A Japanese initiative on this scale is fully in line with recent trends. Japan has recently announced two commitments covering the three years 1987 to 1989. A first commitment of $10 billion was

announced at the Davos Symposium held in Davos, Switzerland, from 29 January to 4 February 1987. Included in this figure was enhanced access for the World Bank to Japan's domestic capital market to the tune of $2 billion; a contribution to IDA of $2.6 billion; to the IMF of $3.6 billion, equivalent to 3 billion SDR; and to the ADB of $1.3 billion.

16. A second set of resource transfer commitments, also for the three years 1987—89, has just been announced by Prime Minister Nakasone at the conclusion of his visit to the United States. The Japanese Government intends "to recycle more than $20 billion, new found, in totally untied form, over three years mainly to the developing countries suffering from debt problems".[7] Since the transfer is to be "totally untied", what is envisaged presumably is enhanced lending either by the Export Import Bank of Japan itself, or by Japanese commercial banks on the strength of a guarantee by the Export Import Bank, mechanisms which are explored more fully below.[8]

17. These two sets of Japanese commitments imply a total transfer of more than $30 billion over the three-year period, averaging over $10 billion a year. Japan transferred a little over $11 billion (of which ODA was $3.8 billion) to developing countries in 1985. If these commitments are additional to the 1985 "net flow" of resources from Japan to developing countries and multilateral agencies, then it would amount to almost a doubling of the 1985 net flow. In all probability however, the flows especially to the multilateral agencies specified in the first commitment, are likely to substitute, in some degree, for previous such flows. It is in this context that a stepping up of the effort to an annual level of $25 billion, and its extension for a five-year period, in the first instance, appears both warranted and reasonable, and can be considered as the beginning of a Japanese Marshall Plan.

18. If the Japanese effort is matched by other developed countries, the positive effect of transfers on this scale on international development cannot be questioned. They will have the effect of improving the import capacity of developing countries, reducing the severity of the austerity implicit in the net outflow of financial resources so far, and of enabling these countries to raise their capital formation levels and economic growth rates. They will also permit a more gradual and longer-term adjustment process, in developing countries facing balance-of-payments problems, and in doing so moderate the stringent conditionality attached to lending by international financial institutions such as the International Monetary Fund and the World Bank, which has had the effect of discouraging developing countries from having recourse to them sufficiently early in the build-up to a crisis. The availability of substantial financial flows ought, therefore, to facilitate considerably the negotiation and implementation of growth-oriented structural adjustment programmes between individual developing countries and these institutions.

19. The lending institutions and countries — and for that matter the borrowing countries — have a common interest in ensuring that funds are used effectively for developmental purposes, and accompanied by better macro-economic policy management. Considerable thought is being given to the reform of institutional frameworks and the establishment of new mechanisms that would be acceptable to both the borrowers and the lenders which might facilitate such an outcome, especially for working out packages for the solution of debt problems. A recent Study Group in Japan, for example, has recommended the following mechanism:

> "The prolonged austerity measures consisting of fiscal deficit reduction, curbing inflation and import restrictions pursued by debtor countries have impoverished economic life of the inhabitants of such countries, (real GNP per capita in Latin America excluding Brazil, Colombia and Panama, has fallen below the 1980 level), which intensified dissatisfaction of the people and this dissatisfaction has become a political issue... The traditional rescheduling packages have been made through independent and case-by-case negotiations by the international organizations, governments and commercial banks. The objective of these packages has been to facilitate a short-term adjustment. In place of these traditional packages we propose the establishment of an "International Co-operation Committee" consisting of major governments, international organizations and commercial banks to help the debtor countries. The committee will endorse an economic reconstruction programme to improve the industrial structure which will enable the debtor countries to sustain economic growth and strengthen export competitiveness. The Committee will conclude with the debtor countries a comprehensive support agreement... for the implementation of the above mentioned economic reconstruction programme."[9]

20. This is the kind of arrangement which seeks to fuse the concerns of growth-oriented adjustment programmes with an **explicit** involvement of major contributing governments and commercial banks. The case-by-case negotiation of **short-term** adjustment packages involving international organizations and commercial banks has been found by experience to be too **ad hoc** because of the excessive austerity resulting from import compression. The new emphasis appears to be on combining programme and project lending with a **longer-term** policy framework aimed at sustaining economic growth and strengthening export competitiveness. If arrangements along these lines succeed in evolving politically balanced packages for the developing countries with which they deal, alongside policies making for more effective macro-economic management and resource allocation, the substantial resource transfers envisaged in our proposals would transform the process of international development.

21. It may, however, not be feasible at this stage of the evolution of the international economy to have an overall International Co-operation Committee for **all** countries, even for debt reconstruction purposes or for financial flows for solving the debt problem. The transfer of resources that is being proposed here would encompass financial flows to **all** developing countries, contributing to the solution of debt problems as well as meeting major resource requirements for infrastructural investment, other project lending, and balance-of-payments adjustment. Some form of case-by-case approach would therefore be unavoidable, and may even be desirable, since what is being addressed are the particular needs of a wide variety of countries. Nevertheless, it will be necessary to ensure "politically balanced packages" of policies, as mentioned above, combining the short-and medium-term compulsions of adjustment, with long-term considerations of growth and investment. It may therefore be desirable to associate with each such package a country-specific Policy Co-ordination Committee, consisting not only of the commercial banks and international lending institutions and the governments of the devel-

oping countries involved in the transaction, but also of the governments concerned with the lending of the funds. This framework can be applied to all types of lending, whether meant for debt reconstruction and rescheduling, for programme lending for balance-of-payment support purposes, project lending, or infrastructural investment.

22. Since a substantial part of the proposed $25 billion annual resource transfers would involve lending for infrastructural investment, it is likely to encounter the argument that developing countries will have difficulty in absorbing them. The contention is that developing countries do not have enough good projects, and that the time taken for project preparation will inevitably limit the pace at which substantial additional financial transfers can be absorbed.

23. There are three levels at which such an argument can be met. If what is at issue is the pace of project preparation, then this is clearly a function of the institutional frame within which projects are developed. While it may be the case that the typical public sector project may take time to prepare, this need not be the case if the funds are channelled in support of private sector activities through flexible institutional mechanisms, for example, for promoting small- to medium-scale businesses or even construction activities. Secondly, even the process of preparing substantial infrastructure projects, e.g. river basin development, road building, port construction, and water supply and construction projects, can be materially speeded up by **ad hoc** project preparation teams put in place by developed donor countries or by international agencies.

24. Thirdly, the rapid expansion of net flows to developing countries in the early 1980s showed that there was no absorptive capacity problem in coping with substantial additional transfers. The substantial inflows that occurred through the private banking system as part of the recycling of OPEC surpluses, took the form essentially of **sector** loans geared to investment programmes as such and not just to particular **ad hoc** projects, where delays in project development might have slowed down the pace of recycling. The prospective round of recycling of developed country surpluses to developing countries could, in principle, be just as expeditious. The only "filter" in the process today would be the "Policy Co-ordination Committee" but there is no reason to anticipate that this would slow down the pace of lending; on the contrary, by facilitating the emergence of **longer-term** policy frameworks in developing countries, and associated economic management disciplines, it could remove a key perceived obstacle to lending today, especially to debtor developing countries.

III. Mechanisms for Implementing a Programme of Substantial Transfers by Japan

25. Several considerations have to be taken into account in any scheme that seeks to mobilize substantial transfers to developing countries. First, there are clear limitations to expanding Official Development Assistance (ODA) on the scale required by the probable dimensions of the external resource deficit of developing countries in the years ahead, viz $40 billion annually by the 1990s. It happens to be the case that the current level of ODA stands at around $30 billion. While it is true that fiscal improvements have occurred in key surplus countries in

recent years,[10] there are clear perceived budgetary constraints, especially if domestic demand expansion policies are also to be accommodated. If the expected developing country external resource deficit is to be met through ODA alone, then the required increase in current levels of ODA — more than a doubling — is highly implausible, given these constraints.

26. What is more feasible are arrangements that build upon the proposition in WIDER's First Study Group Report,[11] that would make the "mobilization of actual capital flows to developing countries a substantial multiple" of the considerably more modest budgetary contributions required for providing interest subsidies, and various forms of collateral. The logic behind any such scheme would be to raise substantial capital sums in private markets against collateral that might require some degree of government budgetary support failing an **explicit** government guarantee, with an interest subsidy, also forthcoming from budgets, to bridge the difference between the cost of borrowing in the capital market and the concessionary rate of interest considered appropriate for lending to low-income developing countries.

27. It is important to appreciate the need for interest subsidies for low-income countries, which cannot absorb substantial amounts of foreign capital on market terms, without building up an unserviceable debt burden very rapidly. It is a reflection of the state of their under development that the benefits of investment, particularly in infrastructure, are so widely distributed as not to be commercially appropriable, or are spread over a long gestation period whose present value cannot be properly assessed in their undeveloped capital markets, or are not easily convertible into foreign exchange to service debt on commercial terms due to the slow growth of exports. This is the reason why it is generally argued that the low-income countries should be supported by concessionary official bilateral or multilateral development assistance. In the event that finance has to be raised for them from the private capital market, interest subsidies would ordinarily be required to make funds available to them on terms which are comparable to the terms of Official Development Assistance.

28. The other essential element needed to mobilize finance from the capital markets of industrial countries, such as Japan, for the developing countries would be some form of **guarantee** of the capital so raised, whether from commercial banks, institutional savers or private individuals. The nature of the guarantee does not have to be uniform for all countries, and in most cases a guarantee by the borrower, or by the government of the borrowing country should be sufficient. When that is not considered adequate, appropriate mechanisms have to be worked out to provide that guarantee either through full or partial collateralization with market-based instruments, or through **explicit** guarantees by the governments of the creditor countries, or by multilateral lending institutions.

29. In principle, if such a scheme for mobilizing finance is multilaterally implemented, it can rely on the guarantee power of the multilateral institutions, such as the World Bank. This, in fact, is what happened with the short-lived "Third Window" of the World Bank. In that instance, World Bank bonds amounting to $1 billion were raised in private capital markets, under the guarantee implicit in the World Bank's callable capital. The market rate of interest at which this sum was raised was subsidized to the borrower by four percentage points through budgetary contributions from OPEC governments. The principal

problem in the context of the more substantial transfers now envisaged is that of the capital adequacy of the World Bank, and the time taken to bring about major capital increases in the Bank even if this is thought feasible or desirable on other grounds.

30. One strategy that appears feasible in the circumstances is for Japan to take a purely unilateral initiative to raise funds in the Japanese capital market and to lend to developing countries. A possible arrangement conforming to this design would be for Japan to designate a government agency that could raise monies in private Japanese capital markets under a Japanese Government guarantee; with an interest subsidy being made available out of the Government budget, by reallocating ODA funds. These loans could fund projects in the countries concerned.

A Japanese Trust Fund

31. This agency could be designated as a **Japanese Trust Fund** located in Tokyo and lending money to developing countries, either bilaterally or in collaboration with the World Bank or any of the Regional Development Banks. Alternatively, it could be located in the World Bank, raise funds in the Japanese market under a Japanese Government guarantee, and disburse these funds in accordance with the World Bank's own programme design procedures. The association with the World Bank would be desirable if other countries were also to join in adding resources to this facility. Otherwise, the Trust Fund should retain its flexibility of operating directly with the borrowing country, or associating with any other institution whose expertise and provisions are found useful in any particular transaction.

32. If the government guarantees needed to raise monies in capital markets are not readily available to the Trust Fund, alternative mechanisms can be found for providing in a Japanese context the equivalent of such guarantees needed to raise the required sums, for transfer to developing countries. The Japanese Government's role may be kept limited, in the main, to providing an interest subsidy at an appropriate level, which could be supplemented as required by whatever additional contributions are necessary to enable these surrogate guarantee mechanisms to be implemented.

33. For example, the Trust Fund could buy "private reinsurance" to cover the value of its own guaranteed loans. This certainly is the case with legislation submitted by the US Administration to Congress in March 1987 affecting US Government agencies. If as in the case of the US,[12] the cost of the reinsurance is viewed as the "true" cost to the Japanese Government of providing loan guarantees, then it is reasonable to expect this cost to be added to the cost of interest subsidies needed for both of which provision will have to be made out of the Japanese Government's ODA budget. The main weakness of this method of providing a surrogate guarantee is the relatively high cost of private reinsurance which may not even be available for amounts as large as those presently envisaged.

34. Alternatively, either the Trust Fund or individual developing countries could borrow from the Japanese commercial banking system, against the collateral of zero coupon bonds issued by an entity or agency

that is separate and distinct from both borrower and lender, and purchased either directly or in the market. Typically, in the case of a borrowing country, the collateral provided by an investment of $300 million in zero coupon bonds of 15-year maturity with a face value of $1 billion (carrying an implicit interest rate of eight per cent) would permit the country to borrow a significant multiple of that investment, viz $1 billion from Japanese banks, simply because the bonds on maturity would yield the $1 billion needed to redeem the commercial bank loan in a single "bullet" repayment. The bond, in the typical case, would thus completely secure the principal of the bank loan, where the loan is set up on the basis that it will be repaid in a single instalment at maturity.

35. The sums required for developing countries to purchase zero coupon bonds would ordinarily come from their own resources but again, typically, all that is required is for the appropriate fraction of the proceeds of a loan to be invested today in zero coupon bonds so that the principal of the loan is fully secured when the bond matures; the fraction not so invested will then be the amount available for the country's use for development purposes, with only the interest payments on the loan requiring to be met. Since the zero coupon bond is nothing more than a device where the initial invested sum compounds to equal the face value of the bond on maturity, the higher the implicit interest rate, and the longer the maturity, the lower will be the fraction of the face value that needs to be invested initially,[13] and the larger the fraction available for the country's use.

36. A more systematic method for arranging substantial and regular borrowings would be to take the Trust Fund route. It would then be possible to think of Japanese bank lending to the Trust Fund, on a scale of $10 billion a year for a five-year period in the first instance, against the collateral of zero coupon bonds of 15-year maturity, purchased by the Trust Fund either from the market, or from special issues by the Japanese Government. The Trust Fund could also borrow directly from the capital market, with the principal of the loan being protected through such collateralization. Because of the magnitudes involved and the consequent spreading of the risk, it might be feasible in fact to operate the scheme on the basis of the collateralization of only a part of the credit risk. If only a half of the risk is secured, it would require no more than an annual investment of $1.5 billion by the Trust Fund in zero coupon bonds of 15-year maturity, instead of the $3 billion investment required for full collateralization; for bonds of 20-year maturity the corresponding investments would be $1 billion and $2 billion respectively.

37. This method of using zero coupon bonds to collateralize the principal of a loan, and to borrow the principal by investing the relevant fraction of it in zero coupon bonds, is a practice that is increasingly coming into vogue in international capital markets. The International Finance Corporation (IFC) has recently proposed to apply this principle to guarantee even direct investment in developing countries in their scheme entitled: Guaranteed Recovery of Investment Principal (GRIP).

38. If the Japanese Trust Fund were to raise money in the Japanese Capital market, say by issuing 15—20 year floating rate obligations, and secure the principal by investing part of the loan proceeds in 15—20 year maturity zero coupon bonds, it can lend the rest of the proceeds to developing country borrowers. Japanese savers will not then be subject to any risk of non-repayment of the principal, collateralized by zero

coupon bonds of equal face value and maturity. The amounts that can be lent by the Trust Fund to the developing countries, and the interest rates charged to them would depend upon the implicit rate of interest on the zero coupon bonds, and the floating rates at which the Trust Fund raises money from the capital market. If the short-term floating rates are lower than long-term fixed maturity bond rates reflected in the implicit rates on the zero coupon bonds, which would be the normal case, the rates charged to the developing country borrowers could remain quite reasonable. The Trust Fund will, however, have to bear the full credit risk on the loan to the developing countries.

39. One important practical difficulty may be the non-existence of a sufficient number of zero coupon bonds outstanding in the Japanese capital market, at a particular time, in relation to the collateralization requirements of annual borrowings by the Trust Fund of $10 billion a year. The Trust Fund could always acquire dollar-denominated zero coupon bonds and combine them with an interest rate and currency swap. An alternative, and in the immediate future more attractive, method may be to persuade the Japanese Government to issue special zero coupon bonds annually for this purpose. The Trust Fund could then invest in them either from its own resources or from advances made by the Japanese Government for this purpose. Borrowing under the scheme is expected to take place within an appropriate longer-term policy framework supervised by a "Policy Co-ordination Committee" as already described, and this will have the effect of ensuring the long-run solvency of borrowers. The Japanese authorities might thus find it not unreasonable in this context to provide budgetary support for the purchase of Japanese Government zero coupon bonds by the Trust Fund. An added consideration would be the fact that any Japanese contribution required for the purchase of zero coupon bonds by the Trust Fund, would have no net financial impact on the Japanese budget until 15—20 years later, since the funds would return immediately to the budget when the bonds are purchased.

40. As regards the terms of lending, a market rate of 5.5 per cent for bank lending of 15-year maturity would seem to require an interest subsidy varying with the situation of the borrower. In a separate section which deals more comprehensively with the interest subsidy issue, we set out the interest subsidy magnitudes resulting from a ten-year Trust Fund loan programme on the scale of $10 billion annually, simply to indicate that even if a five-year programme is extended the subsidy burden is not likely to be onerous.

The Export Import Bank of Japan

41. A second mechanism — and perhaps the most obvious recycling initiative open to Japan — is to raise monies through the Export Import Bank of Japan. The Export Import Bank has been able to tap only a modest fraction of the resources of the Zaisei-Toyushi — the Government's Fiscal Investment and Loan Programme (FILP), including post office savings, government pension funds and other collections — which have amounted in total to $150 billion annually recently. The Export Import Bank's disbursements have recently been $6 billion annually, two-thirds of which derive currently from Zaisei-

Toyushi funds borrowed at 5.2 per cent in ten-year maturities that are typically rolled over, the balance one-third deriving from loan repayments and foreign borrowings. These latter amounts, together with the Bank's paid-in capital of $7 billion, enable it to lend to developing countries on terms as generous as a 15—20 year maturity and a five-year grace period, the loan carrying an interest rate close to its current borrowing cost. A reallocation at the margin of official development assistance for interest subsidy purposes could result in even lower rates of interest, with appropriate arrangements being worked out between the Export Import Bank and OECF.

42. Co-financing arrangements by the Export Import Bank have been around $2 billion a year recently, and substantial additional amounts are in prospect for the immediate future as a result of the recent co-financing agreement between it and the World Bank adopted on 25 March 1987. In terms of this, the Export Import Bank will provide[14] "a new untied loan facility for the co-financing of economic adjustment programmes and investment projects", whereby "assistance will normally be extended to cover a part of the foreign exchange cost of the operations". However, retroactive financing and local cost financing can be considered on a case-by-case basis. These features will help permit a relatively rapid disbursement especially if the monies are used in association with adjustment programmes supported by the World Bank, and they could extend also to similar co-financing arrangements which can be worked out with other regional development agencies.

43. The other principal advantage of co-financing arrangements of this kind is that there is no limit to the amount that can be handled set by considerations relating to the capital adequacy of multilateral institutions, such as the World Bank. Loans granted by the Export Import Bank do not in any way infringe upon or erode the capital base of the partner co-financing institution. The latter enters the picture purely as a vehicle for selecting projects and devising adjustment loans to be financed, and the Export Import Bank enters a transaction at its own discretion. Decisions on extending the co-financing facility for a longer term, or increasing the annual amount made available, are matters essentially within the discretion of the Export Import Bank and the Japanese Government, and there is no other limitation. It will be important that these arrangements also allow for the Export Import Bank to have flexibility in the items to be financed in support of adjustment programmes, so that maintenance imports and working capital requirements can be met, in addition to investment goods and equipment.

44. There have been reports that the Export Import Bank is embarking upon co-financing arrangements with regional development banks, other than the World Bank.[15] While the exact amounts that have been committed are not yet known, the scope for such operations is clearly very substantial.

45. Given the annual flow of resources in the Zaisei-Toyushi to be tapped of $150 billion, it would be quite realistic, and perhaps even conservative, to think of amounts in the region of $10 billion annually for a five-year period, to be extended later if necessary, as being available for co-financing purposes through this mechanism from the Export Import Bank of Japan.

46. The advantage of a recycling mechanism through the Export Import Bank is that it could also seek to raise resources against the

unutilized guarantee power of the Bank. With a paid-in capital of $7 billion, the Bank has a lending and guarantee capability of 11 times that amount or $77 billion. The Bank's present exposure is about $37 billion leaving a hitherto unutilized guarantee capability of around $40 billion. This could be availed of largely to support commercial bank lending by Japanese banks to developing countries, including cover for rescheduling packages made by these banks, in addition to its own direct lending. This could also be used, if necessary, to borrow in international markets for recycling to developing countries, and to support a currency swap arrangement for protecting borrowers against the exchange risks arising out of Yen denominated co-financing loans.

47. If the magnitude of the Export Import Bank's participation in recycling the Japanese surplus to the developing countries that is being now proposed, exceeds the limits of exposure permitted by its present lending-and-guarantee capacity, appropriate steps would need to be taken to increase that capacity. There is reason to suppose that the Bank's present exposure will rise, if the proposed new recycling initiative to highly indebted countries of $20 billion announced by Prime Minister Nakasone[16] were to operate by having recourse to the guarantee capability of the Export Import Bank. One way of increasing the guarantee capability of the Bank further would be to increase its gearing ratio, from the present 10 to 1, to 12 or 15 to 1. The other would be to allow the Bank's capital to increase by a direct contribution from the government; given the present gearing ratio, a $3 billion capital increase, for example, would increase its lending capacity by $33 billion, which would be sufficient to permit the order of lending or guarantees now being proposed, including the "Nakasone round" of recycling $20 billion to debtor developing countries.

48. Between the **Japanese Trust Fund** and the **Export Import Bank** routes for recycling the Japanese surplus, it is proposed that a target should be set for lending annually $20 billion to developing countries, for five years, in the first instance. Given the magnitude of the Japanese surplus and the feasibility of the methods suggested above, it should be perfectly possible to achieve this target. A substantial share of these amounts should be devoted to long-term infrastructure investment in the developing countries, for the reason that they typically yield substantial returns in terms of social cost benefit analysis, and provide a basis for the generation and proliferation of the entrepreneurial opportunities needed for rapid growth. The debtor countries especially have experienced as a result of the austerities of short-term adjustment, a major running down of their capital stock in just this critical area of infrastructure investment — highways, railroads, telephone systems, ports, hospitals and schools — with the prospect of major and possibly inflationary bottlenecks emerging when accelerated development resumes. The opportunity of a large-scale lending programme should, therefore, be seized to bring about the necessary refurbishment of their infrastructure capital stock. Infrastructure requirements however are by no means limited to debtor countries, and are a pervasive need throughout the developing world.[17] While it would be necessary to associate lending for infrastructure development with an interest subsidy mechanism, the relatively long loan maturities needed for this purpose could be accommodated within the recycling mechanisms suggested.

49. A part of the funds to be recycled in this manner should also be used for programme lending, including financing of the local costs of

projects. This may be particularly advantageous in the case of co-financing arrangements when loans are provided in an untied manner, not limited to imports from Japan. But the really vital consideration is that these loans should not be short-term in character, but based on medium-term or long-term programmes. The rationale behind this is the clearly demonstrated fact that bringing about needed adjustments in the economic structure of developing countries is a time consuming process.

IMF Borrowings for the Benefit of Low-income Countries

50. Linked with the long-term nature of the adjustment problem in developing countries, is a third mechanism for recycling the Japanese surplus. This could take the form of a five-year programme for borrowing $5 billion annually from the Japanese capital markets to be lent to low-income developing countries through the IMF in support of medium- to long-term balance of payments adjustment programmes. Currently, the IMF has two facilities for supporting adjustment programmes of this kind, particularly for low-income countries, viz the Structural Adjustment Facility (SAF) and the Extended Financing Facility (EFF). The total resources available to the SAF is fixed, on the basis of the reflows to the IMF's Trust Fund, at about $2.6 billion. The resources for the EFF have no such limit, and given the present liquidity position of the IMF can be expanded significantly, especially because the Fund's own resources can be combined with borrowed resources. The two main reasons why the EFF has not been activated very much in recent years are that the conditionality attached to the facility has been too stringent, and that the interest rates being market based have been relatively high, with very little concessionality. A paradoxical situation has thus arisen, where many low-income countries requiring long-term balance-of-payments adjustment finance have been unable to make use of the principal facility in existence for this purpose, namely, the EFF.

51. It is in this context that we propose that the Japanese Government invite the IMF to borrow a sum of $5 billion annually directly from the Japanese capital market. This would not raise any problem of requiring a guarantee, as an IMF purpose would be considered sufficiently secure by the Japanese capital market to attract subscriptions. It may be necessary, however, to work out a mechanism to cover the exchange risk, if the IMF borrows in SDR's; but there is no reason why the IMF should not borrow in Yen, at least a part of the amount, in which case the IMF bears the risk. In order to induce the IMF to engage in such borrowing, the Japanese Government might agree to provide an interest rate subsidy for the amounts raised by the IMF in the Japanese capital market, so long as this subsidy is passed on by the Fund in the form of reduced interest costs to low-income countries, who are eligible to draw on the EFF.

52. A scheme of this kind possesses several attractions. First, as already mentioned, this method of recycling private funds from the Japanese capital market does not require any additional guarantee. Secondly, an amount of $5 billion raised from Japan can serve to increase the supply of EFF finance to developing countries to about $10 billion, if the Fund uses its own resources. Thirdly, an interest rate subsidy from Japan would lower the cost of borrowing to the users,

thereby increasing the demand for the EFF. With Japan taking the lead, the Fund should be able to persuade other creditor countries to reduce the rate of remuneration they get from the Fund, to match the reduction in the cost of borrowing from Japan, so that the general resources of the Fund are also available to low-income countries at reduced cost. Fourthly, the programmes for balance-of-payments adjustment will be worked out by the Fund, thereby ensuring that proper use is made of the subsidies given by the Japanese Government. However, to activate the EFF to the desired extent, the Fund will have to reorient its adjustment programmes and conditionality practices in the altered context of a substantial availability of finance. Last, but not least, the scheme has the demonstrable advantage of showing that Japan is making a significant contribution to the solution of the balance-of-payments problems of low-income countries in a medium-to long-term framework, with appropriate domestic policy changes and disciplines being incorporated by these countries into their adjustment programmes.

Interest Subsidies and the Recycling Mechanisms

53. The cost of interest subsidies to the Japanese Government would depend upon the difference between the rates at which monies can be raised in the Japanese capital market, and the rates at which it would be appropriate for funds to be lent to low-income countries. As regards market rates for borrowing in Japan's capital market, 15-year bonds could be set in the range 5.5 per cent to 5.75 per cent, and ten-year bonds in the range 5.25 per cent to 5.5 per cent. The Export Import Bank's borrowing rate is 5.2 per cent for loans of ten-year maturity. Commercial bank loans are at 1 per cent above the prime rate of 5 per cent. With all rates now tending to drift lower, a representative "market" rate can be set at 5.5 per cent.

54. Current OECF lending rates to low-income countries provide a suitable guide as to what might be appropriate in their case. OECF rates range from 1.25 per cent for Bangladesh and 1.5 per cent for African countries, to 4.25 per cent for Asian middle-income countries such as Korea, and 4.5 per cent for Brazil and Mexico. A representative "blended" rate to borrowers may, therefore, be set at 3.5 per cent. These "representative" rates imply an interest subsidy on average of two percentage points.

IMF Borrowings

55. In the case of IMF borrowings, Japanese capital market rates are now lower than the current rate of charge in the Fund, so that even without an interest subsidy from the Japanese Government, low-income countries using EFF resources borrowed by the IMF in Japan could have the benefit of rates below the current rate in the Fund. Any interest subsidy on Fund borrowing which may be negotiated between the Japanese Government and the Fund, will obviously help bring EFF lending to low-income countries more in line with current OECF practice.

Export Import Bank of Japan/Japanese Trust Fund

56. As mentioned, the Export Import Bank is able to lend on relatively generous terms in regard to maturity and grace period, with the loan carrying an interest rate close to its current borrowing cost of 5.2 per cent. The range of variation in regard to maturities does not readily permit a simplified projection of interest subsidy magnitudes. In the case of Japanese Trust Fund lending, however, the projection of the annual interest subsidy bill for an annual lending programme of $10 billion for five years is particularly straight forward. Typically, with Trust Fund transactions, a commercial bank loan of 15—20 years maturity would need only to be set up on a "bullet" repayment basis 15—20 years later, for the principal of the loan to be **fully secured** by a zero coupon bond, also of 15—20 years maturity purchased today. There is therefore no **annual** amortization of principal involved — only a **constant** annual interest payment on any single year's loan programme of $10 billion, until the time when the "bullet" repayment of the loan occurs at maturity.

57. Working with an interest subsidy of two percentage points, the interest payment profile for a ten-year lending programme of $10 billion annually therefore means an interest subsidy bill of $200 million in the first year (on lending of $10 billion), rising to $1 billion in the fifth year (on $50 billion), peaking to $2 billion in the tenth year (on $100 billion), if the programme is extended beyond five years, and tapering off thereafter as previous loans are repaid.

58. If the interest subsidy bill is thought of as being met by a reallocation of Japanese Official Development Assistance (ODA) at the margin, then the following orders of magnitude are relevant. Japan's ODA as announced by Prime Minister Nakasone at the end of his US visit,[18] is expected now to double from $3.8 billion in 1985 to $7.6 billion in 1990, and can be presumed to double again to around $15 billion in 1995; indeed these magnitudes may well turn out to err on the side of caution as events unfold. If the Trust Fund loan programme were to begin in 1987, the interest subsidy bill in 1990 of $1 billion will be a little more than 10 per cent of ODA then; even the peak interest subsidy bill of $2 billion in 1996, in the event that the programme is extended to ten years, will be around ten per cent of probable ODA then, tapering off thereafter. These orders of magnitude for interest subsidies do not seem entirely unrealistic in that they can be met essentially out of **incremental** ODA on assumptions that may well prove in time to be conservative.

59. The Japanese contributions required for both interest subsidy and collateral purposes under the recycling mechanisms proposed are also within the target of 0.1 per cent of Japan's GNP, which WIDER's First Study Group Report had suggested that Japan might consider apportioning for these purposes. If Japan's GNP grows in real terms at a rate of 3.5 per cent a year between 1985 and 1990 it would be Yen 375,000 billion in 1990. If the ODA to GNP ratio remains at 0.34 per cent, the ratio achieved by Japan in 1984, and the exchange rate is assumed to be Yen 150 per dollar, the ODA in 1990 should be at least $8.5 billion. Against this, the current target of $7.6 billion in 1990 appears conservative. The developing countries have for long been pressing for the implementation by all developed countries of the 0.7 per cent of GNP target for ODA, which has been exceeded by several countries, such as France, Sweden, Denmark and Norway. Even if that

target is not thought feasible by 1990, a more modest target for Japan to consider reaching by that year might be the ratio of ODA to GNP that the other major surplus country, Germany, had already reached in 1984—85 of 0.45—0.47 per cent. In that event, ODA from Japan could reach a level of $11.5 billion at 1985 prices. This would be equivalent to a target for tripling Japan's ODA during the five years 1985—90, which Japan is very likely to be in a position to do. This order of **incremental** ODA would be more than sufficient to support even more ambitious interest subsidy schemes than any suggested here.

Exchange Risk Protection

60. Additional facilities might also require to be added to these mechanisms, in order to protect the borrower against the exchange risk arising in the case of yen-denominated loans, although it is open to the Export Import Bank to make loans denominated in other currencies. The usual mechanism for protection against exchange risks is a currency swap feature, which is ordinarily possible for loans with a 5—6 year maturity, but not possible for loan maturities in the 10—15 year region. One would require, therefore, an additional mechanism for protecting the weaker party to a currency swap arrangement.

61. An alternative, and far simpler way of tackling the exchange risk issue, would be to allow for an additional 0.5 percentage point interest subsidy to offset exchange risk. This may have the disadvantage, however, that it might not eventually provide full compensation for any future yen appreciation.

Institutional Arrangements

62. The novel recycling mechanism that has been suggested here is the **Japanese Trust Fund** arrangement which has been described in outline. Such an arrangement could be set up in Tokyo simply to administer a purely Japanese initiative. Alternatively it could, if other developed countries seek to join in contributing resources, be set up in the World Bank with, at a minimum, a Japanese representative and a World Bank representative as administrators of the Trust Fund, supplemented as necessary by the representatives of other contributing countries.

63. The Trust Fund could set about its task in one of two ways. At its simplest it could function merely as an arranger of loans. It would line up a particular bank for a particular borrowing country and arrange for appropriate collateralization of loans. Alternatively, the Trust Fund could function as a lender of record. Loans would be booked in the name of the Trust Fund so that all bank lending would flow through it to the borrowing country. The Trust Fund would in this event be able to arrange sub-participations in a particular transaction with a variety of banks. It is this second format for a Trust Fund that may make it more attractive from the perspective of Japan in centralizing management in a single administrative entity. It has the further advantage that because the Trust Fund would develop a portfolio of risk, the total collateralization of risk would be unnecessary.

64. Indeed the opportunity of setting up a **Japanese Trust Fund** might be availed of to endow it with an innovative decision-making

structure. If the objective of the present round of recycling of surpluses is set as one of moving away from **short-term** recessionary adjustment to **longer-term** expansionary adjustment requiring a policy framework aimed at sustaining economic growth and strengthening export competitiveness, there is an opportunity to develop the kinds of policy understandings that might facilitate the emergence of such longer-term frameworks in particular borrowing countries. The obvious option would be to have a supervisory "Policy Co-ordination Committee" of the kind already outlined. The Committee might seek to work on the basis of staff analyses prepared by a pooled **ad hoc** staff from the Fund and the Bank, working with staff seconded for the purpose by interested governments and commercial banks.

A Debt Reconstruction Facility

65. While as mentioned, it is of quite general application institutionally, the device of the Policy Co-ordination Committee would be particularly relevant in the case of the highly indebted countries. The major problem of these countries would be their outstanding exposure to the commercial banks which may make it difficult to channel new money to them on a substantial scale on the basis of any market-based schemes of guarantee. Even with an outright government guarantee, new lending to them may not be attractive unless it is a part of a global effort by which the problems of outstanding debt are separated from the problems of new lending. In other words, for the Policy Co-ordination Committee to work effectively, some appropriate prior international action may have to be taken so that the debt overhang of these countries does not affect their credit worthiness. The alternative of course is for the Committee itself to undertake debt reconstruction on a case-by-case basis keeping in view a longer-term policy framework.

66. There are, however, a number of proposals being aired in the international community which are aimed at debt restructuring and writing down outstanding developing country debt through market mechanisms, rather than through politically negotiated debt relief measures. It is possible for the Japanese Government to take an initiative in this regard and invite other industrial countries to join in the effort to establish a debt reconstruction facility. This would combine ways of removing a large portion of outstanding debt from the books of the commercial banks to securities markets, in the form of more acceptable and liquid forms of paper, with passing on some of the benefits of the writing down of debt, which commercial banks are already practicing, to the indebted countries themselves.

67. Such a debt reconstruction facility can be set up with a relatively small paid in capital supported by substantial callable capital contributed by Japan, United States and other major industrial countries. If the facility is also provided with a high gearing ratio, it should be able to issue a substantial volume of long-term bonds, (25—30 years, with a coupon reflecting a modest spread over equivalent treasuries in the major countries) and exchange them for sovereign developing country debt held by commercial banks at a discount of 25—30 per cent, which is the present average. The reduced volume of debt could then be converted into longer-term loans, on condition that appropriate

longer-term policy reform packages are adopted by debtor countries under the supervision of the Policy Co-ordination Committee.

68. If debt reconstruction were concentrated in the Baker plan countries, reducing the outstanding debt burdens of these countries by 20—25 per cent would mean substantial relief for their annual debt service burden by around $10—12 billion at present interest rates. The resulting improvements in the credit worthiness of these countries, would qualify them for new loans from the international capital market which have hitherto been lacking. Debtor countries would then be in a position to benefit substantially from the resource transfers now being proposed, by being able to concentrate their energies on the appropriate longer-term policy frameworks needed.

REFERENCES AND FOOTNOTES

1 Wharton Econometric Forecasting Associates, January 1987, **Status Report: The debtor countries after the debt crisis,** p. 14.

2 An Analytical and Statistical Appendix provides more detailed support for the line of argument developed in this section.

3 See Analytical and Statistical Appendix, Table 5.

4 Wharton Econometric Forecasting Associates, **op. cit.,** p. 17 forecasts a 1991 surplus of $60 billion. According to the **Project Link Global Outlook** 1987—91: "Japan's large surplus at about $80 billion will not show much change in 1991". See United Nations Committee for Development Planning **Report on the UN/Link Expert Group Meeting (9—11 March 1987) Project Link Global Outlook 1987—91.** document E/AC54/1987/L2 of 9 April 1987.

5 See Analytical and Statistical Appendix, paragraphs 8 and 9.

6 **IMF, World Economic Outlook,** April 1987, Washington, DC, p. 14.

7 **Mainichi Daily News, 3 May 1987,** p. 2, text of remarks by Reagan, Nakasone.

8 See paragraphs 42, 46 and 47 of this Report.

9 Keizai Doyukai (Japan Association of Corporate Executives), **Proposals for Solutions on International Debt Problems,** Tokyo — March 1987.

10 See Analytical and Statistical Appendix, Table 8.

11 Okita, Jayawardena and Sengupta, "**The Potential of the Japanese Surplus for World Economic Development**" WIDER Study Group Series No 1, Tokyo, April 1986, **op. cit.** p. 12.

12 The US position on this matter as presented by the Office of Management and Budget is reported in **The Washington Post** of 13 March 1987.

13 For example, at an implicit interest rate of 5 per cent, an initial investment of 37.243 will, on semi-annual compounding, yield a face value of 100 for a zero coupon bond with a maturity of 20 years. For a lower maturity of 15 years, the initial investment will need to be 47.674. At the implicit interest rate of 8 per cent, the initial investment in a zero coupon bond of 20 years and 15 years maturity respectively will need to be only 20.829 and 30.832 for a face value of 100.

14 World Bank: **Agreement between Export Import Bank of Japan** and the **International Bank of Development on Co-financing**, 25 March 1987.

15 Nihon Keizai Shinbun, 17 April 1987.

16 **Mainichi Daily News,** 3 May 1987 **op. cit.** p. 7.

17 See Analytical and Statistical Appendix, paragraph 2.

18 **Mainichi Daily News,** 3 May 1987 **op. cit.** p. 3.

ANALYTICAL AND STATISTICAL APPENDIX*

1. This appendix provides the economic background to the proposals in the Study Group Report for mobilizing international surpluses for development. Section I documents the present somewhat critical economic situation of developing countries resulting from the phase of recessionary adjustment to the debt problem of the recent past. It points up the $60 billion turn around in financial flows to developing countries — from a net inflow of $30 billion in 1980—81 to a net outflow also of $30 billion in 1985—86 that is now expected to rise to nearly $40 billion at least up to 1991 in the absence of international policy action. Section II focusses on the supply of surplus funds. It assembles recent data on current account balances of the main surplus countries and argues that a number of factors make for their persistence well into the medium-term extending at least into the early 1990s. It also makes a case for diversifying the use of surpluses in the direction of developing countries both from the standpoint of the surplus countries and of the world economy. Section III, while indicating the need for concessions and incentives to induce private funds to go to developing countries, argues that budgetary difficulties hitherto standing in the way of increased Official Development Assistance have been alleviated in the majority of the larger European countries and Japan in recent years.

I. THE ECONOMIC SITUATION IN THE DEVELOPING COUNTRIES

Decline in Investment

2. The rates of gross capital formation have fallen in all developing regions — Africa, Asia, Southern Europe, Middle East, and Latin America and the Caribbean — since 1981. The sharpest fall, of almost one-third, is recorded in Southern Europe between 1978—80 and in 1985, according to an IMF estimate.[1] In 29 low-income countries of Sub-Saharan Africa, the average gross investment rate was 14.3 per cent of GNP in 1984, compared to 19 per cent in 1980, according to a World Bank estimate.[2] In Latin America and the Caribbean, the average gross investment rate in 1985 was 27 per cent below 1981, in the estimate of the Inter-American Development Bank.[3] In a recent statement, the World Bank's Regional Vice President for Latin America and the Caribbean, "recognized the seriousness of the crisis that has already lasted five years, saying that it has affected investment levels in the region, holding back modernization, but also reflecting in the region, holding back modernization, but also reflecting in the deterioration of the existing stock of investment. 'Highways, railroads, telephone systems and other basic infrastructure are worse today in many countries than they were five

* This appendix draws upon a WIDER Working Paper prepared by Dr Dragoslav Avramovic, Economic Adviser, Bank of Credit and Commerce International SA, Washington, DC, USA, whose contribution is gratefully acknowledged.

years ago. Perhaps even more serious, hospitals, schools and other social services have deteriorated, thereby mortgaging the future.'"[4] This situation is encountered, not only in Latin America, but also in most other debt-affected countries, as well as in those which have experienced a severe foreign exchange stringency for other reasons.

3. Unless new resources are found, the setback to development will become cumulative, as the accumulated replacement needs will be absorbing a growing proportion of the available investable resources, leaving a diminishing supply for meeting new (net) per capita investment requirements.

Acceleration of Inflation

4. Despite the decline in investment, inflation in developing countries has accelerated, reflecting the pressure of enlarged debt service payments which were superimposed on traditionally weak government finances. On a weighted average basis, inflation was recently running at double the rate experienced in the 1960s and 1970s.

Table 1

Consumer Prices in Developing Countries, Weighted Averages 1968—86
Annual changes, in per cent

	Average 1968—77[5]	1979	1980	1981	1983	1984	1985	1986[6]
Developing countries	15.2	21.5	27.1	26.1	33.0	37.9	39.6	28.4
By region								
Africa	10.2	16.7	16.4	22.0	19.3	20.0	13.1	12.6
Asia	8.8	8.0	13.1	10.6	6.6	7.2	7.4	5.8
Europe	10.0	25.9	37.9	24.1	23.1	28.0	28.6	27.1
Middle East	9.8	11.7	16.8	15.1	12.3	14.7	11.7	11.2
Western Hemisphere	27.9	46.5	54.2	59.0	102.7	123.4	145.7	86.5

5. Many stabilization programmes of recent years have failed, partly because of their multiplicity of objectives: reduction of inflation, correction of distortions in product and factor prices, and quick turn around in trade accounts in order to generate external surpluses. Correction of price distortions has normally called for price increases. The generation of external surpluses has drained goods from the domestic market. Consequently, both have militated against price stabilization. The latter calls for a temporary net inflow of resources, parallel with a restoration of integrity of the fiscal system and exchange rate stabilization. The job of reconstruction of monetary systems still remains to be done in many developing countries.

Reverse Financial Transfers

6. In 1986, for the third year in a row, service payments — amortization and interest — of developing countries on their long-term debt exceeded their long-term borrowing, resulting in a large and growing cash drain.

Table 2

Debt, Gross Borrowing, Debt Service and Net Financial Transfers of Developing Countries, 1980—86 (US$ Billions)

	1980	1981	1982	1983	1984	1985[7]	1986[7]
All Developing Countries[8]							
Debt Disbursed and Outstanding	429.6	493.6	551.2	630.2	673.4	730.9	775.0
Disbursements	102.8	122.8	115.8	96.5	88.3	81.7	72.0
(From Private Creditors)	74.6	91.3	83.9	63.9	56.1	52.1	41.0
Debt Service	74.2	87.6	97.4	90.8	99.0	108.0	101.0
Principal Repayments	42.0	46.5	48.8	44.0	46.3	53.5[9]	51.0
Interest	32.2	41.1	48.6	46.8	52.7	54.5	50.0
Net Transfers	28.7	35.2	18.4	5.7	—10.7	—26.3	—29.0
Highly Indebted Countries[10]							
Debt Disbursed and Outstanding	204.1	244.4	276.5	329.2	354.0	367.6	382.0
Disbursements	53.2	69.5	60.1	39.7	32.3	22.4	21.0
(From Private Creditors)	46.0	60.9	50.9	29.7	22.5	13.6	12.0
Debt Service	44.4	51.5	56.6	48.2	51.6	50.1	47.0
Principal Repayments	24.6	26.1	25.8	19.1	18.4	17.1	16.0
Interest	19.8	25.4	30.8	29.1	33.3	33.0	31.0
Net Transfers	8.8	18.0	3.5	—8.5	—19.4	—27.7	—26.0

7. The estimated cash drain (net transfer) on long-term debt from all developing countries of US$28 billion per year in 1985—86 compares with their average cash inflow of US$32 billion in the peak years 1980—81. It is this swing of US$60 billion per year which indicates the enormous adverse change in the availability of resources in developing countries. The swing is even greater when short-term flows are taken into account, as they were positive in the later 1970s and early 1980s, and negative in recent years. The reverse flow has been particularly marked in Latin America. As stated in the Declaration of Montevideo of the Cartagena Consensus Group, 1985 was the fourth year in succession that financial resources were transferred out from Latin America in net terms, "making a grand total in excess of US$100 billion, equivalent to one-year's gross investment in the region."[11] In Sub-Saharan Africa, positive net transfers of more than US$11 billion in 1982 fell to US$3.5 billion in 1984, as a result of a rapid rise in debt service liabilities, disappearance of private credits and a reduction of IMF credit.[12]

8. Wharton Econometric Forecasting Associates have projected the external financial flows for 21 major debtor countries in 1987—91.

Table 3

Projection of Net Financial Transfers of Major Developing Countries, 1987—91[13] (US$ Billions)

	1981	1984	1985	1986	1987	1988	1989	1990	1991
Net New Borrowing	56.2	22.2	17.5	24.4	20.8	22.8	22.6	15.3	12.1
Interest Payments	53.3	57.8	53.8	47.2	46.7	51.4	55.6	53.9	50.9
Net Financial Transfers	2.9	—35.6	—36.3	—22.7	—25.9	—28.6	—33.0	—38.6	—38.8
For Information									
GDP Growth Rate p.c.	—1.1%	1.0%	0.3%	—1.5%	1.0%	1.3%	1.0%	1.6%	1.3%
Average Interest Rate	10.5%	9.2%	8.1%	6.6%	6.2%	6.5%	6.8%	6.5%	6.1%

9. The projected net financial transfer averages US$30 billion per annum over the three years 1987—89, rising to nearly $40 billion, 1990—91. These are the amounts which need to be found to revise what Wharton finds inappropriate in their forecast result: "The flow of financial resources from the economically less developed countries to the more developed countries (continues to be) the opposite of what would be desirable under normal circumstances."[14] The same thought is expressed by Professors Eichengreen and Portes in their recent comparative study of financial developments in the 1930s and the 1980s: "The international capital market still does not appear to be working properly, with the bulk of net flows now going from areas of high real marginal productivity to areas of lower productivity."[15] The assessment of a World Bank spokesman when presenting the latest World Debt Tables was similar. He stressed that developing countries had made good progress in the adjustment of their internal economic policies, but that the other two indispensable conditions for the resumption of their economic growth had failed: capital flows did not resume and financial transfers in the direction of creditor countries increased, and the world economy developed only sluggishly which kept down the demand for developing country exports.[16]

Terms of Borrowing

10. The effects of the large decline in interest rates in the key financial markets in recent years failed to be transmitted to the majority of developing countries. While nominal (money) rates on their loans fell, the "real" rates, taking into account the changes in their export prices (or terms of trade), did not. Depressed commodity markets and competitive pressures on prices of manufacturers have resulted in a sharply increased real debt burden.

Table 4

Nominal and Real Interest Rates Paid by Developing Countries

	1981	1982	1983	1984	1985	1986
(1) Average Interest Rate[17]	10.5	10.4	8.7	9.2	8.1	6.6
(2) Change in Export Prices[18]	0.4	—5.5	—5.6	0.6	—4.2	—5.9
(3) Average Real Interest Rate[19]	10.1	15.9	14.3	8.6	12.3	12.5

11. The average real interest rate paid by the 21-country sample in the last six years works out at 12.7 per cent per annum. These findings are confirmed by a World Bank analysis which suggests an average real rate of 14.9 per cent for all developing countries in 1981—85.[20] These orders of magnitude compare with the historical real rate of interest in developed countries averaging 2 per cent per annum.

12. It is essential that as large a part of additional capital inflow be supplied to a large number of developing countries on as lenient terms as possible over the next five years or so, in the light of the following:

(a) The imports of 17 highly indebted countries in 1986 fell for the fifth year in a row, and their value was little more than 60 per cent of the 1981 level.[21] Sub-Saharan African countries showed a similar pattern, with imports again down in 1986.[21]

(b) Interest payments of the Latin American countries are now running at 35 per cent of their aggregate exports of goods and services, a proportion higher than the total debt service (amortization and interest) on public debt in most Latin American countries during the Great Depression of the 1930s.[22] Debt servicing obligations of several other non-Latin American major debtors are also very large.

(c) It is unlikely that any significant debt relief will be provided by any sustained increase in international export prices over the medium term. Most major commodities still suffer from excess capacity, international competition in manufactured goods is severe, and world market demand prospects are not buoyant. The World Bank's latest projection of non-oil commodity prices shows further declines in 1987 and 1988 from a deeply depressed level of 1986, and only a slow recovery in 1989 and 1990.[23] While surprises in commodity markets are always possible, it is risky to count on them in the present instance.

(d) The aggregate rate of output growth of developing countries was under 2 per cent in 1981—85, below the rate of population growth and substantially under the international rate of interest. There is now a possibility, for the first time since the war, of a vicious cumulative compound growth of external debt, or a debt trap, where debt increases faster than output and external debt service absorbs a steadily growing proportion of income. This possibility can be avoided by a temporary reduction in the rate of interest pending the resumption of a rapid sustainable output growth in debtor countries.

II. SUPPLY OF SURPLUS FUNDS

Trade and Current Account Surpluses

13. West Germany and Japan ended 1986 with formidable trade surpluses of US$53 billion and US$86 billion respectively — larger than anybody expected.[24] Their surpluses on current account were smaller because of negative net service payments, but they were still enormous. Moreover, other Western European countries were also in surplus. The European Economic Community as a group posted a trade surplus in 1986, the first in their 30-year existence.[25]

Table 5

Current Account Balances, Main Surplus Countries (US$ billions)

	1982	1983	1984	1985	1986 IMF Estimate Oct. 1986	1986 IIF Estimate Jan. 1987	1987 IMF Estimate Oct. 1986	1987 IIF Estimate Jan. 1987
Japan	6.9	20.8	35.0	49.2	82.7	89.0	74.1	94.0
West Germany	4.1	4.2	6.5	13.3	30.8	36.0	25.5	42.0
Switzerland	3.8	3.8	4.0	5.2	7.9[26]	(	7.9	(
United Kingdom	7.0	4.8	2.1	4.9	2.3	(	1.3	(
						18.0		28.0
France	—12.1	—4.7	—0.8	—0.1	5.5	(	6.5	(
Italy	—5.5	0.8	—2.9	—4.2	5.5	(	3.0	(
Total	4.2	29.7	43.9	68.3	134.7	143.0	115.7	164.0
For information:								
United States	—9.1	—46.7	—106.5	—117.7	—123.0	—143.0[27]	—123.0	—119.0

Accumulation of Reserves and Dollar Depreciation

14. Most of the Japanese and European surpluses have been invested in the US, primarily through purchases of government securities, in direct private investment, real estate and the purchase of company shares in the market. A part of this financing, through the build-up of central bank balances and purchase of US Treasury bills (short-term paper) has been reflected in an enormous increase in these countries' foreign exchange reserves, particularly during 1986 and early 1987.

Table 6

Foreign Exchange Reserves of Surplus Countries
(US$ millions)

	December 1985	December 1986	January 1987
West Germany	39,025	45,866	56,311
Japan	22,328	37,657	46,693
France	24,319	28,428	NA
Switzerland	17,463	21,334	18,288
Italy	14,029	18,115	19,426
United Kingdom	9,741	14,886	15,342
Netherlands	9,170	9,582	10,199
Belgium	3,969	4,630	3,911
Total	140,044	180,498	NA

Source: IMF, International Financial Statistics, March 1987.

15. The accumulation of reserves by surplus countries of US$40 billion during 1986 represents essentially the intervention of foreign governments and central banks in the currency market. "Hence at the exchange rate that prevailed last year, private capital inflows to the US were not enough to finance its current account deficit. Without official intervention, the dollar would have fallen even further than it has."[28]

Surpluses: For How Long?

16. The sharp depreciation of the US dollar vis-a-vis the surplus country currencies since February 1985 will, in due course, work to reduce the Japanese and European surpluses. The measures of internal expansion in Europe and Japan and of budgetary contraction in the US, reaffirmed at the Paris Monetary Conference at the end of February 1987, will contribute to this end. An adjustment in trade volumes is already under way, although there are complications in these figures.[29]

Table 7

Trade Volume Developments
Percentage change over corresponding period in previous year

	United States		Japan		West Germany	
	Exports	Imports	Exports	Imports	Exports	Imports
1985	2.1	5.3	4.4	0.4	5.9	4.2
1986	4.1	13.5	—1.3	12.5	1.4	6.3
1986 Q1	0.5	13.0	—0.2	3.6	—0.8	2.8
Q2	0.0	11.6	—1.0	16.8	4.6	12.1
Q3	6.7	18.4	—0.3	18.7	0.7	3.7
Q4	9.4	10.6	—4.1	14.4	1.1	6.7

Source: GATT, **International Trade in 1986 and Current Prospects,** as shown in **Financial Times,** 2 April 1987

17. These changes in trade volume have failed to be reflected in trade values so far, for two reasons. First, the delay in the effects of the US dollar depreciation has been considerable, partly because of the readiness of exporters to the US market to accept lower profits, in order to retain the market share.[30] Secondly, the increases in US export volume have been marginal in relation to the size of the US trade deficit: in 1986, US exports amounted to only 56 per cent of US imports, and therefore exports would have to rise twice as fast as imports in order to start to close the US trade value gap.

18. Several factors will tend to sustain the surplus position of Japan and Europe in the medium term:

(a) Interest and dividend income on their loans and investments in the US will increase sharply, and this will help substitute in part for any decline in trade surplus they may sustain. The US negative net investment position ("Net foreign debt") has been estimated at US$257 billion at the end of 1986.[31] It is projected to deteriorate by US$500—600 billion by 1990.[32] Interest and dividend payments by the US are estimated at US$45—70 billion in 1990, compared to US$16 billion in 1986.[33]

(b) Internal expansion in Europe and Japan will take time to get under way in present unfavourable conditions, and therefore their absorption of imports will increase only gradually. They now operate under deflationary pressures of major currency appreciations and therefore their domestic investment and growth are slow. "The prospects for continuing trade frictions and the doubts about the exchange rate restrain investment by corporations. Thus savings will remain higher than investment in Japan, and the balance will continue to seek investment outlets in foreign countries."[34] In West Germany, "it is likely that the economy won't expand this year at even the modest 2 per cent rate forecast only a few months ago... German business is scaling back investment."[35]

(c) A reduction in the export dependence of the Japanese and European economic growth will take time under any circumstances. Exports account for 35 per cent of the German GNP. In Japan, its "leaders realized they had to change the way the country's economy worked. They could no longer rely on exports and a closed domestic market for prosperity. 'But it will take time — as long as five years. There is no possibility here of a quick fix. Trade surpluses of tens of billions of dollars cannot be wiped out in one stroke.' "[36]

19. At the present state of knowledge, it is not possible to forecast the length of the period during which the Japanese and the European surpluses will continue to be generated. No precedents for the present size of these surpluses exist other than the US surplus after the end of the Second World War. It took then about 15 years for the US surplus position to be wound out.[37] There are, however, differences in the specific situations then and now, and they preclude drawing too close analogies. A major turn around in world commodity markets on a broad scale might bring about a sharp worsening of European and Japanese positions. On balance, what seems safe to assume is that Japan and Western Europe will have plenty of funds available for external lending through the early 1990s, at least.

Desirability of Diversification

20. Diversification in the use of surplus funds in the direction of developing countries is desirable for a number of reasons:

(a) There is a growing determination in wide circles of US public opinion and government that the US trade gap needs to be narrowed down substantially and quickly. The Morgan Guaranty analysis suggests that the US trade gap should be cut by US$100 billion annually "before the end of this decade",[38] **i.e.**, from US$170 billion in 1986 to US$70 billion in 1990. Targets suggested by other responsible bodies are even higher. An improvement of the trade position by at least US$100—150 billion annually over the next four years is suggested; an improvement of as much as US$200 billion per annum might in fact be necessary if the US were to return to current account balance, **i.e.**, to eliminate the present deficit and to finance interest payments on its growing net foreign debt.

(b) A turn around of US$150 billion annually is equivalent to 8 per cent of current world exports. Unless an outlet is found elsewhere — within the economies of the surplus countries and in developing countries — an enormous pressure on export prices, export volumes and exchange rates is in the making.

(c) Protectionist pressures are now contained only barely, and trade frictions of serious magnitude and acerbity are growing. Unless a new source of demand for goods is activated, prospects for peaceful settlement of trade disputes are bound to diminish.

(d) An exclusive emphasis on investments of surpluses in developed countries carries two risks. First, there will be resistance to growing foreign takeovers of direct investment, for a number of reasons. Secondly, growing placements in financial investments coincide with the deterioration of the value of assets through currency depreciation caused by the trade imbalance, which may affect not only the investment increment, but also the value of the capital stock.

21. The above arguments do not mean that from the viewpoint of an individual investor, or even of an individual surplus country, an investment in a developed country is more risky than an investment in a developing country, on the average. What these arguments mean is that both from the viewpoint of surplus countries and of the world economy, a partial diversification in future trade and investment is desirable.

III MOBILIZATION OF SURPLUSES

Need for Incentives

22. The first WIDER Study Group report has stressed the need for concessions and incentives to induce private funds to go to developing countries. The same thought was expressed by Mr Yusuka Kashiwagi, Chairman of the Board of Directors of the Bank of Tokyo, on 28 September 1986:

> "I don't think that this concentration of Japanese capital going to the United States or into US dollars is really so desirable, because if Japan is the major saver of the world, I would like to see more of the savings used in countries where savings

are so needed that is, in the developing countries. But why doesn't the money from Japan flow more into developing countries? There could be many reasons, one of which may be that the Japanese Government does not provide the necessary environment that would encourage Japanese capital to move into developing countries. By that I am referring to the amount of the risk — that is, the greater risk of lending to or putting money in a country that is in the course of debt rescheduling or that is having debt problems. Unless there is some kind of encouragement, especially in the form of fiscal encouragement, it would be very difficult to increase the flow of Japanese capital into these countries at a time of international debt problems. The debt problem is a key problem of the world today, and the question is how to move more private capital into developing countries. I would think that the Japanese Government should see to it that there is more encouragement in this field by way of fiscal and other measures.[39]

23. The deficit position of the public sector in most countries has been considered a major obstacle to increasing public assistance to developing countries. Another major obstacle has been the concern with the equality of donors in burden sharing.

Fiscal Problem

24. The government deficit position, after deterioration in the late 1970s and early 1980s, has been alleviated in the majority of larger European countries and Japan in recent years.

Table 8

Indicators of Fiscal Position, Selected Developed Countries (In per cent of GNP or GDP)

A. General Government Financial Balances: IMF Estimate

	Average 1975—84	1984	1985	1986[40]	1987[41]
Japan	—3.8	—2.2	—1.6	—1.7	—2.0
West Germany	—3.1	—1.9	—1.1	—0.8	—0.7
France	—1.6	—2.9	—2.6	—2.5	—2.5
United Kingdom	—3.7	—4.2	—3.1	—2.9	—3.0
Italy	—10.5	—13.0	—14.0	—12.0	—11.1

B. General Government Budget Balances: BIS Estimates[42]

	1973	1980—81	1982—83	1984	1985[43]
Japan	0.7	—4.1	—3.7	—2.2	—1.3
West Germany	1.2	—3.3	—2.9	—1.9	—1.1
France	0.9	—0.8	—2.9	—2.8	—2.5
United Kingdom	—2.6	—3.1	—3.0	—3.9	—3.6
Italy	—7.0	—10.0	—12.5	—13.5	—13.7

C. **Gross Investment, Saving and its Components: BIS Estimates**[44]

		Gross domestic investment	Gross domestic saving	Net private saving[45]	Public sector deficit[46]	Net external lending[47]
Japan	1971—79	33.5	34.2	20.3	—6.3	0.7
	1980	32.2	31.1	15.8	—6.7	—1.1
	1981	31.3	31.7	16.6	—7.3	0.4
	1982	30.1	30.8	15.6	—6.9	0.7
	1983	28.3	30.1	15.1	—6.8	1.8
	1984	28.2	31.0	15.8	—5.8	2.8
	1985	28.2	32.1	15.1	—3.6	3.9
Germany	1971—79	23.0	23.8	11.6	—1.9	0.8
	1980	23.5	21.5	10.3	—2.9	—2.1
	1981	21.0	20.0	9.5	—3.7	—1.0
	1982	19.7	20.1	9.4	—3.3	0.4
	1983	20.4	21.0	9.8	—2.5	0.5
	1984	20.8	21.7	10.0	—1.9	0.8
	1985	20.3	22.3	10.3	—1.1	2.0
France	1971—79	24.0	23.6	10.6	—0.6	—0.4
	1980	23.6	22.2	8.2	0.2	—1.4
	1981	21.2	19.7	7.5	—1.8	—1.5
	1982	21.7	18.6	6.7	—2.6	—3.1
	1983	19.8	18.1	6.7	—3.2	—1.7
	1984	19.3	18.6	7.5	—2.8	—0.7
	1985	18.9	18.2	7.6	—2.5	—0.7
United Kingdom	1971—79	23.8	23.1	14.5	—4.8	—0.6
	1980	19.8	21.2	11.8	—4.7	1.4
	1981	17.6	19.8	10.0	—3.3	2.2
	1982	17.5	19.8	9.5	—2.7	2.3
	1983	18.1	19.7	9.9	—3.7	1.6
	1984	18.7	20.7	11.5	—4.2	2.0
	1985	18.9	19.7	11.0	—3.5	0.8
Italy	1971—79	21.8	21.6	15.7	—8.6	—0.2
	1980	25.0	22.0	16.0	—8.0	—3.0
	1981	21.5	19.5	15.5	—11.9	—2.0
	1982	20.2	17.9	15.1	—12.5	—2.2
	1983	17.8	18.0	13.7	—12.5	0.2
	1984	19.0	17.8	14.1	—13.5	—1.2
	1985	20.4	18.5	14.6	—13.7	—1.9

25. Fiscal improvement has been particularly marked in West Germany, Japan and Switzerland; the last country has now moved into an overall budgetary surplus. Other countries still show public sector deficits, however, although reduced; and while there are strongly held views that the present slow pace of economic activity, excess capacity, zero inflation and external surplus combine to allow a substantial room for deficit expansion, the memory of large budgetary deficits in the not-too-distant past and the apprehension of possible future flare-ups are powerful brakes. Plans for tax reduction and public expenditure expansion are now under way, in carefully designed doses.

26. Official development assistance did not increase in 1985, the last year for which comprehensive data are available. Annex IV provides an OECD mid-1986 summary review. It is the fiscal problem which was a major obstacle in recent years. This is now gradually changing in the major surplus countries.

ANNEX I

Gross Capital Formation in Developing Countries, 1978—86
(In per cent of GDP)

	Developing Countries: Gross Capital Formation, 1978—86[48]								
	1978	1979	1980	1981	1982	1983	1984	1985	1986[49]
Developing countries	28.0	26.6	26.6	26.3	25.1	24.0	23.4	22.8	22.8
By region									
Africa	27.9	25.0	25.8	28.5	24.9	22.4	20.8	19.5	20.2
Asia	29.4	29.7	28.9	27.6	27.3	27.2	27.1	27.0	26.2
Europe	32.3	31.6	30.3	29.1	27.7	24.9	24.0	23.7	23.9
Middle East	27.5	24.0	25.1	26.3	26.5	30.3	28.3	26.3	26.3
Western Hemisphere	25.0	23.0	23.4	22.8	20.9	17.3	17.5	17.2	17.8
Memorandum									
Median estimates									
Developing countries	25.4	25.6	25.5	25.5	24.3	21.9	20.8	19.9	20.0
By region									
Africa	25.6	25.4	23.5	25.6	22.7	19.8	19.3	19.7	19.5
Asia	24.2	27.3	28.9	27.5	25.2	24.8	22.1	20.7	20.8
Europe	33.9	32.3	32.6	31.0	31.6	27.1	24.8	23.4	23.6
Middle East	27.2	25.9	23.7	23.4	27.0	25.7	23.8	20.9	24.5
Western Hemisphere	24.0	25.1	25.5	23.2	21.2	19.9	19.0	18.5	18.6

Source: International Monetary Fund, **World Economic Outlook,** October 1986, p. 44.

ANNEX II

Gross Investment and Savings in Low-income Africa[50]
(In per cent of GDP)

	1960—69	1970—74	1975—79	1980	1981	1982	1983	1984 (preliminary)
Gross domestic investment	14.8	17.9	18.3	19.0	18.1	16.6	14.8	14.3
Gross domestic savings	14.0	15.0	10.1	8.4	6.8	6.4	6.3	6.4
Resource balance	—0.7	—3.0	—8.2	—10.8	—11.5	—10.4	—8.3	—7.8

Source: World Bank, **Financing Adjustment with Growth in Sub-Saharan Africa 1986—90,** February 1986, pp.v and 8.

ANNEX III

Gross Domestic Investment as a Share of GDP, 1961—85
In Latin America and the Caribbean

	Average			Annual				
Country	1961—70	1971—80	1981—85	1981	1982	1983	1984	1985
Argentina	18.6	21.7	14.8	18.8	16.6	15.0	13.0	10.9
Bahamas	NA	5.9	10.2	10.2	10.2	10.2	10.1	10.1
Barbados	19.4	25.2	30.3	33.1	29.6	29.5	29.5	29.5
Bolivia	18.7	20.9	12.6	17.0	11.0	11.0	9.6	14.5
Brazil	21.1	28.1	21.8	24.4	23.4	21.6	19.8	19.9
Chile	19.2	17.8	15.5	27.6	11.1	9.3	15.3	14.4
Colombia	19.6	19.1	21.3	21.8	22.7	21.5	20.1	20.2
Costa Rica	18.9	24.2	18.5	18.2	14.6	18.9	19.4	21.2
Dominican Republic	13.9	23.9	20.2	21.7	19.8	19.5	19.6	20.7
Equador	21.4	24.7	19.8	22.1	24.6	17.4	17.5	17.5
El Salvador	13.3	16.4	11.8	13.1	12.5	11.3	11.5	10.5
Guatemala	11.4	13.5	10.2	12.9	11.0	9.4	9.7	8.2
Guyana	38.0	31.4	26.4	31.7	25.2	27.6	23.4	24.1
Haiti	6.0	14.5	18.8	18.1	17.5	18.3	19.1	21.0
Honduras	16.4	19.9	17.0	21.3	13.3	14.1	18.6	17.9
Jamaica	28.8	21.3	14.1	13.7	14.2	14.1	14.2	14.3
Mexico	20.6	23.6	21.0	30.0	21.5	17.1	17.7	19.5
Nicaragua	19.0	15.1	20.7	24.4	20.2	21.0	21.6	22.3
Panama	22.1	27.7	19.5	25.5	22.4	17.7	16.2	15.7
Paraguay	10.8	21.0	23.6	30.6	25.6	21.6	20.0	20.3
Peru	16.2	16.1	16.6	21.0	19.9	15.1	14.6	12.5
Suriname	NA	NA	NA	NA	NA	NA	NA	NA
Trinidad & Tobago	24.7	18.6	25.0	27.6	28.3	25.9	21.7	21.4
Uruguay	10.2	13.1	12.0	16.6	15.0	10.5	9.5	8.4
Venezuela	24.9	34.6	24.0	29.0	32.5	16.8	20.9	20.9
Latin America	20.0	24.5	20.1	25.0	21.7	18.1	17.9	18.2

NA: Not available.

Source: Inter-American Development Bank, based on official statistics of member countries.

ANNEX IV*

Financial Resources for Developing Countries:
1985 and Recent Trends

The 1985 ODA Record

In 1985, Official Development Assistance from DAC countries as a group reached $29.6 billion. This represented an increase of $0.8 billion

* This annex is taken from OECD Report A(86)27 of 18 June 1986.

or 3 per cent over 1984. In real terms, i.e. measured in constant (1984) prices and exchange rates, DAC ODA rose by 1.8 per cent. Bilateral DAC aid rose by as much as 12.0 per cent, largely reflecting the response by DAC members to the special problems of Sub-Saharan Africa, both in the form of emergency aid and assistance to help African countries in their structural adjustment efforts. A particularly significant parallel development in this regard is the strong increase in resources raised for emergency and development purposes by private voluntary agencies in DAC countries, which reached over $3 billion in 1985.

Contributions to multilateral institutions recorded in 1985 declined. However, this reflected the accidental timing of contributions of a number of major donors, especially to IDA, holding back the overall DAC aid growth rate which, in the absence of this accidental factor would have exceeded the trend rate of 3.5 per cent in real terms recorded in recent years.

It is also this factor which together with accelerated GNP growth in the DAC member countries, explains the slight decline in the ODA/GNP ratio from 0.36 per cent to 0.35 per cent.

Among DAC members, Norway ranked highest in 1985 in terms of the share of its GNP devoted to aid, with an ODA/GNP ratio of 1.0 per cent. Other donors exceeding the 0.7 per cent target are — as in recent years — the Netherlands, Sweden, Denmark and France (if DOM/TOM aid is included). Large increases in percentage terms were reported by Austria, Finland, Sweden, Ireland, Germany and Switzerland. The largest expansion of ODA volume in absolute terms was recorded by the United States, Germany, France and Sweden.

The 1985 ODA Record for Individual DAC Countries

Australia's ODA disbursements in 1985 increased in national currency by 21 per cent, and in real terms by 13 per cent, to US$749 million. As a per cent of GNP, ODA disbursements rose to 0.49 per cent compared with 0.45 per cent in 1984. The increase was largely the result of higher deposits of notes with IDA. The Australian Government has stated its intention to increase its aid programme in real terms.

Austria's ODA net disbursements increased significantly in 1985 compared with 1984 both in national currency (41 per cent) and real terms (38 per cent). The ODA/GNP ratio progressed from 0.28 to 0.38 per cent. However, as regards bilateral ODA the increase was almost exclusively due to higher disbursements of official concessional exports credits and, as regards multilateral ODA, to a bunching of deposits to international financial institutions. As both these items are expected to be significantly lower in 1986, the prospect is for a decline in Austria's ODA in 1986 and following years.

Belgium's ODA remained stable in national currency in 1985 but fell by 5.0 per cent in real terms to $430 million; expressed as a proportion of GNP, ODA decreased from 0.57 per cent in 1984 to 0.53 per cent in 1985. The decline reflects the impact of budgetary factors which reduced commitment levels, and reductions in official contributions associated with private export credits, which met delays arising from the application of aid criteria and the identification of eligible projects. Multilateral contributions were also lower mainly for reasons relating to the timing of notes. The Belgium ODA/GNP ratio is likely during the

next few years to remain within a band of 0.55 to 0.60 per cent of GNP.

Canada's ODA disbursements in 1985 increased by 6 per cent in national currency and 3 per cent in real terms to US$1.64 billion. However, as a per cent of GNP it fell from 0.50 per cent in 1984 to 0.49 per cent in 1985. Whilst net bilateral loans fell considerably, bilateral grants increased slightly and contributions to multilateral agencies, in particular to IDA, rose significantly. The Canadian Government recently decided to stabilize ODA volume at 0.50 per cent of GNP until 1990, so ODA may be expected to increase roughly in line with the growth of Canada's GNP over the next few years.

Denmark's ODA disbursements in 1985 correspond to 0.80 per cent of GNP. Compared with the previous year this represented a decline of 0.05 points from 0.85 per cent of GNP. The reduction was exclusively due to a bunching of multilateral contributions in 1984 and does not represent a general trend. On the contrary, Denmark's ODA volume is expected to increase significantly in view of the Government's recent decision to increase the aid budget gradually to 1 per cent of GNP in 1992.

The growth of **Finland's** ODA since 1978, when the Government undertook to reach the 0.7 per cent target by the end of the present decade, continues to be one of the most rapid and sustained among DAC countries. Rising by 15 per cent in real terms, ODA at 0.39 per cent of GNP in 1985 was for the first time above the DAC average. ODA appropriations for 1986 amount to 0.47 per cent of GNP, and are to reach 0.55 per cent in 1987.

France's ODA to independent countries (i.e., excluding flows to the DOM/TOM), which the French Government will endeavour to raise to a level of 0.7 per cent of GNP in 1988 or as soon as possible thereafter, continued to progress rapidly, reaching 0.54 per cent of GNP in 1985. An increase in multilateral contributions, in particular to IDA, and a substantial rise in net bilateral lending accounted for the growth of aid in 1985.

Germany's ODA in 1985 recovered by 9 per cent in national currency and 7 per cent in real terms. As a percentage of GNP it rose from 0.45 per cent in 1984 to 0.47 per cent in 1985. This increase resulted mainly from a substantial rise in the bilateral aid programme and multilateral contributions, the latter mainly due to a higher deposit of funds with IDA. The current medium-term assistance plan provides for an average annual growth rate of aid appropriations of 2.9 per cent until 1989, which could lead to some further increase in ODA in real terms in this period.

Ireland, which joined the DAC in November 1985, began to extend ODA in the Sixties and expanded its aid programme after joining the EEC in 1973. Disbursements have been on a rising trend since, increasing to 0.22 per cent of GNP in 1984. In 1985 they rose by a further 9 per cent in real terms to $39 million or 0.24 per cent of GNP. The increase was spread over both the bilateral and the multilateral programmes. On present aid policies the upward trend in Ireland's ODA can be expected to be maintained.

The rapid rise in **Italy**'s ODA was temporarily interrupted in 1985. Although budget allocations increased, timing factors affected multilateral disbursements. As a result, although bilateral-disbursements continued to progress, rising by 25 per cent in real terms, total ODA fell by 3 per cent in real terms to $1,099 million and decreased as a proportion of

GNP from 0.33 per cent in 1984 to 0.31 per cent in 1985. A resumption of growth can be expected in 1986 and beyond, as Italy progresses towards achievement of the 0.7 per cent target.

The rapid expansion of **Japan's** ODA met with a temporary setback in 1985 mainly due to the timing of its multilateral contributions, while bilateral ODA increased by 5.3 per cent over the previous year, including an increase in grants of 11.4 per cent. Two instalments of Japan's contributions to IDA, amounting to $1.2 billion, having been paid in 1984, disbursements in this area fell back by more than $600 million in 1985. Japan's ODA/GNP ratio fell from 0.34 per cent in 1984 to 0.29 per cent in 1985. The prospects for ODA disbursements in the coming years are more favourable under the newly established Third Medium-term Target for 1986—92.

The Netherland's aid, which has exceeded the 0.7 per cent target every year since 1973, fell by 10 per cent in real terms in 1985 and declined as a proportion of GNP from 1.02 to 0.91 per cent. The decrease, which affected all the major components of the aid programme, can be expected to be temporary given the Netherland Government's continued commitment to devote 1.5 per cent of net national income to development co-operation. ODA disbursements may accordingly be expected to recover to a level close to 1 per cent of GNP in the coming years.

New Zealand's ODA/GNP ratio, which had been on a downward trend since the mid-1970s, stabilized in 1985 at 0.25 per cent, the same result as in 1984. ODA disbursements rose by 15 per cent in nominal terms and 2 per cent in real terms. The main development was an enhanced aid effort in Sub-Saharan African countries. Despite the Government's vigorous efforts to reduce New Zealand's budget deficit, it has indicated that there should be a recovery in the real level of New Zealand aid in the near future.

Norway's ODA in 1985 increased by 8 per cent in national currency and 2 per cent in real terms. At 1 per cent of GNP its ODA/GNP ratio was the highest among the DAC countries in 1985 (it reached 1.03 per cent in 1984). Given the Government's strong commitment to aid objectives, the ODA/GNP ratio may remain at around the current level despite Norway's serious current economic difficulties.

Sweden's ODA disbursements in 1985 rose by 18 per cent in national currency and 10.5 per cent in real terms. As a percentage of GNP, ODA recovered from 0.80 per cent in 1984 to 0.86 per cent in 1985. All areas of the programme participated in this recovery; the increase in bilateral grant aid was particularly notable, due mainly to a major aid effort in Sub-Saharan Africa. Appropriations are presently planned to remain at a level corresponding to 1 per cent of GNP.

In 1985 **Switzerland's** ODA increased by 7 per cent in real terms, and progressed from 0.30 to 0.31 per cent as a proportion of GNP. This increase was due mainly to higher multilateral outflows, in particular to regional development banks. Switzerland's ODA may be expected to further increase moderately in real terms and as a percentage of GNP.

The **United Kingdom's** ODA increased in 1985 in national currency by 10.4 per cent and by 4.6 per cent in real terms. As a percentage of GNP it rose to 0.34 per cent. Considerable impetus was given to disbursements by a substantial rise in aid to Sub-Saharan African countries. The British authorities expect that on present plans up to 1988—89, aid levels will be more than maintained in real terms. This may nevertheless imply a slight decline in the ODA/GNP ratio over the same period.

The sustained expansion of the **United States** ODA in real terms continued in 1985, with a rise of 6.2 per cent in 1984 to a record level of $9.6 billion. The substantial growth of United States aid did not, however, lead to a change in the ODA/GNP ratio for the United States, owing to the rapid growth of GNP. An increase of close to $1.9 billion in bilateral disbursements, largely in the form of Economic Support Fund assistance (principally to the Middle East) but also in food aid and other grants to Sub-Saharan African countries, more than made up for a temporary $1 billion decline in contributions to multilateral organizations (which reflected a delay in the fiscal year 1986 contribution until January 1986). Growing concern regarding the size of the Federal budget deficit is a source of future uncertainty, but the impact of budget cuts is not likely to be visible in calendar year 1986 disbursements.

Net Disbursements

	US$ Million				% of GNP					% Change 1985/1984			
	1984 actual	1985 actual[a]	1985 at 1984 exchange rates	1985 at 1984 prices & exchange rates	1979/80 average	1982/83 average	1984/85 average	1984	1985	In national currency at current prices[b]	In 1984 dollars and prices	(memo) at current prices and exchange rates	Annual Growth rate of ODA 1979/80—1984/85 in real terms
	1	2	3	4	5	6	7	8	9	10	11	12	13
Australia	777	749	940	881	0.50	0.53	0.47	0.45	0.49	21.0	13.4	—3.6	(0.8)[c]
Austria	181	248	256	249	..	(0.30)	0.33	0.28	0.38	41.6	37.5	37.0	..[d]
Belgium	442	430	442	420	0.54	0.59	0.55	0.57	0.53	0.0	—5.0	—2.7	1.1
Canada	1,625	1,638	1,726	1,675	0.45	0.43	0.50	0.50	0.49	6.3	3.1	0.8	4.3
Denmark	449	440	450	428	0.73	0.75	0.83	0.85	0.80	0.2	—4.6	—2.1	4.3
Finland	178	211	218	204	0.22	0.30	0.38	0.36	0.39	22.1	14.7	18.5	15.0
France, incl. DOM/TOM	3,788	4,022	4,135	3,905	0.62	0.74	0.78	0.77	0.79	9.2	3.1	6.2	5.7[c]
France, excl. DOM/TOM	2,552	2,768	2,845	2,687	0.35	0.47	0.53	0.52	0.54	11.5	5.3	8.5	10.1
Germany	2,782	2,935	3,035	2,971	0.44	0.48	0.46	0.45	0.47	9.1	6.8	5.5	1.2[c]
Ireland	35	39	40	38	0.17	0.21	0.23	0.22	0.24	15.7	8.8	13.4	6.7
Italy	1,133	(1,099)	1,195	1,099	0.13	0.24	0.32	0.33	0.31	5.5	—3.0	—3.0	21.0
Japan	4,319	3,797	3,812	3,756	0.30	0.31	0.31	0.34	0.29	—11.7	—13.0	—12.1	5.7
Netherlands	1,268	1,135	1,174	1,149	0.95	0.99	0.97	1.02	0.91	—7.4	—9.3	—10.5	0.8
New Zealand	55	54	63	56	0.33	0.28	0.26	0.25	0.25	15.0	2.0	—1.0	—2.7
Norway	543	555	584	553	0.91	1.06	1.01	1.03	1.00	7.7	2.0	2.3	4.5
Sweden	741	841	875	820	0.85	0.93	0.83	0.80	0.86	18.0	10.5	13.4	1.0
Switzerland	286	301	315	307	0.23	0.28	0.30	0.30	0.31	10.1	7.4	5.3	7.9
United Kingdom	1,430	1,531	1,578	1,495	0.42	0.36	0.34	0.33	0.34	10.4	4.6	7.1	—3.7
United States	8,711	9,555	9,555	9,250	0.23	0.25	0.24	0.24	0.24	9.7	6.2	9.7	3.3
Total DAC Countries	**28,743**	**29,580**	**30,393**	**29,256**	**0.30**	**0.37**	**0.36**	**0.36**	**0.35**	**5.7**	**1.8**	**2.9**	**3.6**

a. Figures are influenced downward, with the exception of the United States, by the appreciation of the dollar in 1985. Data corrected for this effect are shown in column (3), and for the effects of both dollar appreciation and price changes in column (4).
b. Figures in 1984 dollars, column (3) divided by column (1).
c. To maintain statistical comparability, the growth rates exclude the recent inclusions in aid statistics of imputed student costs.
d. Comparable data available only from 1983. In the 3 years 1983—1985, Austria's ODA increased by 11.3 per cent, annual average.

ANNEX V

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6 Preliminary. Inflation has accelerated towards the end of the year. Source: IMF, **World Economic Outlook, op.cit.,** p.48.

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19 Row (3) equals rows (1)—(2).

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39 **The 1986 Per Jacobsson Lecture,** Washington, DC.

40 Preliminary.

41 Forecast.

42 Including the social security sector, but excluding capital transactions of a financial nature.

43 Preliminary.

44 Data for 1985 are preliminary.

45 Gross saving less government saving and an estimate of depreciation.

46 For Japan and the United Kingdom public sector deficits differ from general government deficits shown under B above.

47 Including the statistical discrepancy in the National Accounts.
Source: IMF, World Economic Outlook, **op. cit.**, p. 21; Bank for International Settlements, **Fifty-sixth Annual Report,** Basle, 1986, pp. 26 and 63.

48 Except where otherwise indicated, arithmetic averages of country ratios weighted by the average US dollar value of GDPs over the preceding three years.

49 Preliminary estimate.

50 The following countries are included:

Benin	Kenya	Senegal
Burkina Faso	Lesotho	Sierra Leone
Burundi	Liberia	Somalia
Central African Republic	Madagascar	Sudan
Chad	Malawi	Tanzania
Ethiopia	Mali	Togo
Gambia	Mauritania	Uganda
Ghana	Mozambique	Zaire
Guinea	Niger	Zambia
Guinea-Bissau	Rwanda	

Selection of press comment on WIDER's proposal for Mobilizing international surpluses for world development: A WIDER plan for a Japanese initiative

THE JAPAN TIMES • FRIDAY, 8 MAY 1987

Study group urges more Japanese money for developing nations

Japan should make $125 billion available to the developing nations over the next five years, using its huge current account surplus to assist them in their economic development, a study group at the United Nations University said Thursday.

The group at the university's World Institute for Development Economics Research (WIDER), headed by former Japanese Foreign Minister Saburo Okita, made the proposal in a report published in Tokyo.

It said Japan should implement a $125 billion, five-year plan to "recycling" part of its trade surplus to developing countries at an annual rate of $25 billion.

In the fiscal year to March 1987, Japan posted a current account surplus of $93 and a trade surplus of $101 billion – both record highs – according to preliminary figures released by the Finance Ministry.

The Helsinki-based group suggested the creation of a Japanese Trust Fund, which would borrow $10 billion from commercial banks for each of the five years.

It also suggested two other approaches which it said would be viable – the extension of $10 billion annually in credits from the Export-Import Bank of Japan, making better use of its co-financing programs and its guarantee, and the raising of $5 billion a year by the International Monetary Fund (IMF) in the Japanese capital market for use in its enlarged lending facilities.

The report said the special fund would buy zero-coupon bonds from markets and from the Japanese government – which at present issues no such obligations – for use as collateral in borrowing from commercial banks. The proceeds would then be lent to developing countries.

The WIDER group said the Export-Import Bank should step up its co-financing arrangements beyond the recent levels of $2 billion a year.

Japan's Surplus Could Be Sent To Poor Nations

TOKYO (AP) – A research institute of the United Nations University proposed Thursday that Japan mobilize $25 billion a year from its trade surplus to help developing nations where living levels, income and investment have fallen "catastrophically".

Proposing a five-year plan of assistance, a 10-member study group of the World Institute for Development Economics Research said, "if (Japan's initiative) is matched by other developed countries, this would transform the paradoxical situation in which developing countries find themselves today, of having to transfer resources to the outside world, instead of being, as is normal, the net recipients of capital inflows."

The plan was outlined at a news conference by former Japanese foreign minister Saburo Okita, chairman of the institute's board, and two other officials of the study group. The institute was set up in Helsinki, Finland, in 1984 by the Tokyo-based United Nations University.

"Judging from the scale of Japan's surplus, we consider it possible and desirable for Japan to implement" the proposal, Mr. Okita said.

Japan's trade surplus is expected to remain substantial over the next five years, in the range of $60 billion to $80 billion annually, the group's report said.

It said there has been a turnaround in capital flows in the 1980s, with an inflow of $30 billion from the developed countries to the developing countries in 1980–81 changing to an outflow of $30 billion in 1985–86.

The result has been a corresponding decline in imports in the developing countries, the report said, adding, "as a result, their levels of living, and levels of income and investment have fallen catastrophically. This is not sustainable."

U.N. Institute Urges Japan to Recycle Surplus

A research institute of the United Nations University called on Japan Thursday to take the initiative to launch a five-year program to plow $25 billion annually to developing countries in a bid to recycle part of its surplus.

The prosposal was made in a report by the World Institute for Development Economics Research (WIDER) announced in Tokyo by its director Lal Jayawardena and Saburo Okita, chairman of the board.

According to the proposal, an annual amount of $10 billion would be recycled in collateralized borrowing from Japanese commercial banks and the capital market through a "Japanese trust fund," which would be located in Tokyo or in the World Bank.

Another $10 billion, the report said, would be borrowed through the Export-Import Bank of Japan by stepping up its cofinancing arrangements and better utilizing its guarantee power.

In addition, it proposed that the International Monetary Fund be allowed to raise $5 billion in the Japanese capital market for the longterm lending to low-income countries.

These ideas, both in scale and concept, are built on what Japan is currently engaged in, said Jayawardena, referring to the Japanese government plan to recycle a total of $30 billion in a 1987–1989 period.

Okita, former foreign minister and also chairman of the WIDER study group who compiled the report, said that the annual rate of $25 billion as proposed by WIDER is "desirable" for Japan, when the size of its surplus is considered.

Tokyo urged to lend more to poor nations

A NOVEL PLAN for using $25bn a year Japan's huge current account surpluses to finance Third World development has been proposed by the United Nations University in Tokyo.

The plan, advanced by the World Institute for Development Economics Research, says both the liquidity problems of developing countries and the trade frictions caused by Japan's surpluses could be eased by a big increase in loans from Japan to developing countries.

"There is a potential for setting a virtuous circle going," Dr Lal Jayawardena, director of the institute, said yesterday.

He believes the need for a new approach is urgent. "If the US tries to correct its trade deficit, that could take 8 per cent out of world exports unless there is demand expansion simultaneously elsewhere".

The proposal for $25bn a year in new loans over the next five years would represent a huge increase on Japan's $5bn a year aid effort. It would also be greater than the commitment by Prime Minister Yasuhiro Nakasone in Washington last week to lend more than $20bn over the next two years to the Third World.

The plan hinges on creating significant new borrowing capacity in those developing countries that are already over-indebted. The solution prosposed is that commercial banks which hold the existing debt should agree to let a market value be put on it. That would cause its value to fall, enabling the developing countries to redeem it as part of restructuring packages that included news loans.

This step would also get round the objections expressed by the Japanese Government that any loans would be of more benefit to creditor banks than to the poor countries.

The other crucial criterion, says Dr Jayawardena, is that the new loans be closely supervised. They should be tied directly to medium-term development policies that would increase the ability of developing countries to service their debt. High-powered surveillance committees should be set up in each recipient country to make sure that the plans are adhered to.

Dr Jayawardena, a former treasury secretary in Sri Lanka, said the recycling of the oil exporting country surpluses in the 1970s to developing countries failed largely because of the lack of supervision. A bold initiative was necessary because of the dangerous trends in world trade. On the one hand, the US was cutting its reliance on imports, which could deflate the world economy.

Meanwhile, the Third World was making net transfers of funds to the developed countries, mainly because of the large debt repayment obligations of a few countries.

The institute suggests three ways of raising private sector funds for its recycling proposal.

- Japan's Export Import Bank used its government guarantee and access to the huge pool of postal savings to raise $10bn a year for untied co-financing deals with the World Bank.
- A new agency, the Japanese Trust Fund be set up to raise up to $10bn a year in the Japanese market.
- The International Monetary Fund be enabled to borrow $5bn a year in Japan's capital market for programme lending to low income developing countries, preferably with an interest rate subsidy from the Japanese government.

Japan Urged To Employ Trade Surplus For Aid

A research institute of the United Nations University proposed Thursday that Japan mobilize 25 billion dollars a year from its trade surplus to help developing nations where living levels, income and investment have fallen "catarstophically."

Proposing a five-year plan of assistance totaling 125 billion dollars, a 3-member study group of the World Institute for Development Economics Research said, "If Japan's initiative is matched by other developed countries, this would transform the paradoxical situation in which developing countries find themselves today, of having to transfer resources to the outside world, instead of being, as is normal, the net recipients of capital inflows."

The plan was outlined at a news conference by former Japanese Foreign Minister Saburo Okita, chairman of the institute's board, and two other officials of the study group.

The institute was set up in Helsinki in 1984 by the Tokyo-based United Nations University.

'Judging from the scale of Japan's surplus..., we consider it possible and desirable for Japan to implement" the proposal, Okita said.

Japan's trade surplus is expected to be substantial over the next five years, in the range of 60 billion to 80 billion dollars annually, the group's report said.

It said there has been a turnaround in capital flows in the 1980s, with an inflow of 30 billion dollars from the developed countries to the developing countries in 1980–81 changing to an outflow of 30 billion dollars in 1985–86.

The result has been a corresponding decline in imports in the developing countries, the report said, adding, "As a result, their levels of living, and levels of income and investment have fallen catastrophically. This is not sustainable."

According to the group's proposal, 10 billion dollars of the annual 25 billion-dollar recycling program would be raised in the Japanese capital market through a "Japan trust fund" to be set up in Tokyo in the form of mortgage loans.

Another 10 billion dollars would be raised through loans guaranteed by the Export-Import Bank of Japan, with the remaining 5 billion dollars raised by the International Monetary Fund in the Japanese capital market.

The funds, the report said, would be used to finance projects in the hard-hit developing countries.

Okita said his group has yet to officially sound out the Japanese government about the five-year plan, which he said could be implemented through cooperation between the government and the private sector.

An imaginative recycling plan

FINANCE MINISTERS meeting this week in Paris under the auspices of the OECD can be under no illusions about the health of the world economy. The OECD, like other forecasters, has revised down its already modest growth projections. The dollar remains fragile despite a rising interest rate differential in its favour. Chronic trade and international debt difficulties remain unresolved. Never has an imaginative strategy for tackling these interlinked problems been more urgently required.

Policymakers seeking constructive solutions should examine the proposals put forward in Tokyo last week by Dr Saburo Okita and his colleagues at the World Institute for Development Economics Research. The report, Mobilising International Surpluses for World Development, urges the Japanese Prime Minister to consider a much more ambitious recycling of the trade surplus than he proposed in Washington a fortnight ago. Mr Nakasone talked of new untied loans to developing countrties worth $20bn over three years; Dr Okita suggests than $125bn over five years is closer to what is needed.

Global perspective

The *wider* report takes the view that the size of Japan's surplus is much less important than how it is spent. From a global perspective, the pressure on Japan (and to a lesser extent West Germany) to stop fanning protectionism by saving too much is slightly irrational. It makes sense only within the narrow frame of reference of industrialised countries and ignores the fact that the debtors of the Third World are being forced to transfer resources to the rich north because new loans are falling far short of repayments of interest and principal.

The attack on excessive saving in Japan is thus occuring against a backdrop of an acute shortage of capital in the Third World. A sizeable reduction in the unsustainable US trade deficit is certainly desirable; the point to remember is that this does not entail an equal and opposite reduction in the Japanese and West German surpluses. Within reason, there is a way for these countries to avoid what they see as excessive domestic reflation and to continue to rely on export-led growth: they can finance a move into sizeable deficit on the part of developing countries.

Magnetic pull

Dr Okita and his colleagues do not think Japan should try to reduce its current account surplus (forecast at slightly over $80bn in 1987) below about $50bn for the foreseeable future. But they do think that at least $25bn a year should be ear-marked for developing countries. Capital, however, will not flow of its own volition to the Third World.

There are all kinds of obstacles: new lending is seen as extremely risky because of the huge overhang of old debts, direct investment by companies is impeded by legal and political constraints, and portfolio investment is circumscribed by the volatility and tiny capitalisation on borrowers. On top of this, US markets exert a magnetic pull–last week Japanese investors were again bidding aggressively for US Treasury bonds despite months of currency and capital losses.

The diversion of foreign capital away from the US would be a much better way of forcing Americans to live within their means than protectionism. The question however, is whether finance ministers are willing to pay more than lip service to ambitious plans to recycle the surpluses to the Third World. The *wider* study argues the case for the setting up of a special trust fund, for explicit government guarantees on loans to the debtor countries, for interest rate subsidies, for a bigger role for the world Bank and the IMF and for a decisive reconstruction of the overhang of old debt.

None of these proposals is likely to appeal to finance ministry officials, but that does not mean they should not be considered by the politicians. It can sometimes be riskier to do nothing than to do something.

Japanese generosity

There is less to Japan's promise to recycle $30 billion-worth of its trade surplus as aid to developing nations than meets the eye.

Japan has a reputation for repackaging previous commitments and then presenting them as something new. Plus a change. When the Japanese finance minister, Kiichi Miyazawa, gave details on May 12 th of how Japan would honour the promise made by his prime minister, Yasuhiro Nakasone, during his visit to Washington earlier this month, it turned out that one-third of the $30 billion was untied loans Japan pledged last year to developing nations. The remaining $20 billion of recycled surpluses will come through three other forms of untied loans:

- $8 billion in capital subscriptions to the World Bank, the Asian Development Bank and the Inter-American Development Bank, and funds to be raised by these banks through bond issues on the Tokyo markets;
- $9 billion through syndicated loans by the Export-Import Bank of Japan, Japanese commercial banks, the World Bank, the Asian Development Bank and Japan's Overseas Economic Co-operation Fund;
- $3 billion in untied loans from the Export-Import Bank of Japan.

There is a further catch, which will not surprise those hardened to little disappointments from Japan: the whole package is to be spread over three years.

The limited scope of the Japanese plan can be gauged by comparing it with the prosposals put out by the World Institute for Development Economics Research (WIDER) on May 7th. WIDER reckons that the Japanese should stump up a total of $125 billion over the next five years. The need for capital movements of this scale is demonstrated by the turnaround in the capital flows to developing nations: in 1980–81 they saw a capital inflow of $30 billion, in 1985–86 this was reversed and there was a capital outflow of the same magnitude (likely to grow to $40 billion in the early 1990s).

This affects the industrialised countries too. The institute points out that developing countries have been forced to curtail their imports. If America were to eliminate its current-account deficit, a turn-around equivalent at least to 8 % of total world exports, this would have a major inflationary impact and there would be an even greater need for capital inflows to the poorer nations.

WIDER even suggests a mechanism to achieve the $25 billion-a-year disbursments. It envisages $10 billion being recycled through collateralised lending from a new Japanese Trust Fund (which liases with the World Bank), $10 billion through the Export-Import Bank of Japan and $5 billion through the IMF. This is rather hopeful, given the unlikelihood of the Japanese accepting the proposal.

New Marshall Plan in embryo?

AT A TIME when the United States and Japan are at loggerheads over the vexed issue of mitigating the mounting trade imbalance, a prosposal of the kind which the World Institute for Development Economics Research (WIDER)–the Helsinki based reserarch unit of the United Nations University–has enunciated does come as a pragmatic focus on the enormous constructive potential locked up in the teeming trade surpluses of Japan. According to the Finance Ministry of Japan, the overall surplus reached a new peak of $101.43 billions in 1986 compared to $61.60 billions in the previous year. That the U.S. deficit vis-a-vis Japan was itself more than $58 billions in 1986 was a maniifestation both of the very strong post-War interdependence between the two economies and of the steady deterioration over the past decade in the competitive capacity of U.S. manufactures. The WIDER plan in all probability will evoke an active response from the Nakasone administration–if only because it is an expression of the conviction that the present tragic combination of the tepid climate of growth in the industrialised countries and the debt tangle in which most of the developing countries are caught bodes ill for all. The idea that Japan should bestir itself to siphon off a massive flow of $125 billions over a five year period in order to stimulate development in the poorer countries with a predictable multiplier effect on the global economy, is not entirely an invention of the WIDER. Did not the Marshall Plan which the U.S. deployed during the immediate post-War period for raising the economies of Western Europe and Japan from the rubble prove how a rich creditor nation could act in enlightened self-interest? In fact there has been growing evidence that macroeconomic policy in Japan itself was moving towards the recognition that, with its exalted creditor-nation status–of which the steep increase in the net outflow of capital from $92.39 billions to $144.63 billions in 1986 is more than eloquent proof–it ought to apply its resources on a big scale for the benefit of the developing countries. Japan's record in Official Development Aid (ODA) in more than matching the norm of 0.7 per cent of GNP is itself a credential for the new mandate. The Prime Minister, Mr. Yasuhiro Nakasone, clearly indicated during his recent visit to Washington that his Government would take every possible step to funnel government and private sector funds in that direction. There can be no doubt that the WIDER plan is in keeping with Japan's recent thinking. Enhanced access for the World Bank to Japan's domestic capital market to the tune of $2 billions, a commitment of $2.6 billions to the IDA replenishment and contributions amounting to about $5 billions to the IMF and the ADB have already been announced, covering the period 1987–1989. At the conclusion of his U.S. visit, Mr. Nakasone announced his Government's intention to recycle more than $20 billions in a "totally untied form" for the purpose of providing assistance to the debt-ridden countries. Considered in such a background, the WIDER plan may well prove a new rallying point for international financial agencies like the World Bank and the IMF as well as perhaps for some sections of the commercial banking system.

The WIDER study group led by Dr. Saburo Okita would appear to have worked on the premise that, despite all the "humming and hawing" at the political level in Japan, the surpluses on current account will continue to loom large in the annual range of $60–80 billions over the next five years. The proposal of the group is that Japan should recycle $125 billion out of the current surplus of $300–400 billions during the next five years to

the developing countries at an annual rate of $25 billions through a Japanese Trust Fund and the Export-Import Bank of Japan with modalities of co-financing with the IMF and the World Bank being worked out on a country-to-country basis rather than presumably bound up with the present straitjacket of conditionalities imposed by these agencies. An integral element in the proposal is the interest subsidy which will absolve the LDC borrowers from the onerous obligation to service debt at near-commercial rates. The WIDER initiative is admittedly not designed to cry halt to the asymmetry in the trade relations between the U.S. and Japan. Nor does it point to any painless process of industrial restructuring whereby Japan could turn its back on the inheritance of an export-dominated economy. What the new plan seems to promise is that the positive dimension of the huge trade surplus of Japan would direct policy not just at securing realignment of trade or currency parities between the two industrial giants but at other areas of a world which hold, in terms of the sheer magnitude of their potential markets, the key to the new frontier in global economic expansion.

EDITORIAL

Sharing the wealth

How should we view Japan's massive trade surplus, which has reached nearly $100 billion per year? Is it the devious culprit behind the current disruption and imbalance in the world economy? Or is it a resource which can fuel further expansion of the world economy?

There is the persuasive argument that the problem of Japan's massive trade surplus cannot be solved simply by expanding the domestic economy. Instead, it is claimed. Japan should take the bold step of channeling its massive surplus toward investment in developing countries and thus make a positive contribution to world development. A concrete plan based on this concept was recently unveiled by WIDER (World Institute for Development Economics Research), a research organ of the United Nations University.

This concept of recycling the trade surplus had already been widely discussed as a possible Japanese "Marshall Plan." The WIDER proposal, however, deserves special attention, as it details a specific strategy for the government and the private sector to work together in providing financing, or "economic co-operation" in the Japanese phraseology, to developing countries.

The WIDER plan estimates that Japan's trade surpluses will run from $60–$80 billion annually over the next five years. It calls for recycling one third of the surplus, or $25 billion per year, to developing countries. This would be especially useful in arresting the outflow of capital from the developing countries which has occurred over the past several years.

For its part, the Japanese Government would provide the assistance and guarantees necessary to allow developing countries to borrow from Japan's financial institutions at market terms. The scheme would operate through three separate mechanisms. First, a "Japanese Trust Fund" would oversee the distribution to developing countries of $10 billion per year in secured loans from Japan's commercial banks and capital markets. A policy adjustment committee would establish a framework for long-term project lending and maintain close contacts with the World Bank. Second, the Export Import Bank of Japan would oversee the distribution of $10 billion in loans guaranteed by the bank itself. Finally, the International Monetary Fund would borrow $5 billion from Japanese financial institutions to provide long-term balance-of-payments support to low-income countries.

But the effectiveness of this plan involves more than just technical considerations. It depends on a fundamental change in the world's economic structure. In the long term, no progress will be made if this recycling of funds is treated simply as a temporary subsidy to help restore the balance of payments of the developing countries. Rather, it must be viewed as an opportunity to initiate a cycle of economic growth, fueled by exports to the developed countries. Otherwise, the infux of recycled capital will simply be recycled back to the developed countries, through imports of capital equipment and other goods. On this point, it is crucial that the recycled funds be offered in the form of untied loans which need not be spent on imports from Japan. It is also important to coordinate loans and financing with efforts to resolve the heavy debt burdens now plaguing many developing nations. Finally, Japan must adopt a fundamentally new approach to aid and economic co-operation which focuses on the expansion of developing country exports to Japan and other industrialized nations.

AID AND INVESTMENT

New efforts to be a 'responsible' global partner

Prime Minister Yasuhiro Nakasone, on his official Washington visit in early May, played a political trump card by announcing Japan would recycle US$30 billion of its huge trade surplus over three years to developing countries. He was upstaged just days later in Tokyo by a proposal that Japan send out US$125 billion over five years.

The upstaging was no coincidence. World Institute for Development Economics Research (Wider) chairman Saburo Okita knew Nakasone would announce in Washington an aid package to help ease current US-Japan frictions: So he waited to incorporate Nakasone's package with that of his study group within Wider, which is based in Helsinki and is affiliated with the UN University in Tokyo.

Okita's team's proposal is entitled Mobilising International Surpluses for World Development: a Wider Plan for a Japanese Initiative. As this suggests, it is a challenge to Japan to set an example to be followed by other industrialised countries to help counter the capital outflow from developing countries, estimated by Wider at US$30 billion during 1985–86.

Its recommended annual recycling programme consists of US$10 billion sent out through collateralised lending from Japanese commercial banks and the capital market, through a Japanese Trust Fund that would form country-specific project-lending plans and liaise with the World Bank; US$10 billion through the Export-Inport Bank of Japan, and US$5 billion as borrowings by the IMF from the Japanese capital market to support the balance of payments of low-income countries.

The programme, on the drawing board since April 1986, is very similar to that announced by Nakasone, mostly differing only in amounts, and is excellent, a Foreign Ministry aid-policy spokesman said.

Wider reports a lack of response from the Japanese Government so far, but there has been an influx of requests from ministries and agencies for a copy of the plan. Checks revealed copies had only recently been received and were being studied closely.

The preliminary reaction at the Foreign Ministry, however, was that the government could not afford the Wider plan, despite the fact it clearly states funds would be raised in the private sector. For it is private business which is raking in Japan's huge trade surplus, which Wider estimates will continue at US$60–80 billion annually over the next five years.

Only two-thirds of the package Nakasone announced in Washington is new. This US$20 billion-worth tentatively includes US$8 billion in loans through the World Bank, the Asian Development Bank (ADB) and the Inter-American Development Bank; more than US$9 billion via Japan's Overseas Economic Cooperation Fund, the Export-Import Bank of Japan and private Japanese banks, and about US$3 billion in direct loans funded exclusively through the Eximbank, said the Ministry of Finance.

The remainder, actually US$9.5 billion, was announced at the end of last year, and government officials are now talking of the Nakasone package as being worth US$20 billion, not US$30 billion. This section includes US$2 billion to set up a Japan Special Fund in the World Bank; US$3.6 billion for a credit line through the IMF, and, in replenishments, US$2.6 billion to the World Bank–affiliated International Development Association and US$1.3 billion to the Asian Development Fund.

The total US$30 billion is untied, and contains a small amount of official development assistance (ODA), the point being to use private funds as much as possible.

Nakasone's plan is a serious attempt to recycle Japan's trade surplus. But it seems weak in comparison to that of Wider, considering the huge increase in the value of the yen against the US dollar since late 1985.

The recent boast that Japan will complete its aid-doubling plan two years earlier than scheduled in 1990 also rings a little hollow when bearing in mind the increased power of the yen. And the hollowness rings a little louder in light of the fact that Japan's ODA budget for fiscal 1987 is down 4.1 % from the previous year, to ¥ 1.2 trillion, the Foreign Ministry said in January. The drop was caused by a delay in yen-loan projects; it is hoped this will be alleviated by an average 0.6 percentage-point drop in interest rates from January.

Recycling Japan's trade surplus in the form of aid to developing nations is a sign of the modernisation of Japan's aid policies. Target countries, too, are changing according to global conditions and Japan's increasing status within the global community. Debt-laded Latin American countries are likely to benefit most from Nakasone's aid package, while Asia has traditionally been the focus of aid. More attention will also be paid to African countries, a Foreign Ministry spokesman said.

Asia received 67.8 % of Japan's bilateral ODA in 1985, at US$1.73 billion. Africa received a paltry US$252 million (9.9 % of bilateral (ODA), and Central and South America, US$225 million (8.8 %). Oceania received US$24 million (0.9 %).Figures for 1986 are now being calculated.

China has been the top recipient of Japan's ODA since 1982, netting 14.4–16 % of total disbursements between that year and 1985. Projects are overwhelmingly infrastructural and these are decided every five years according to China's five-year plans.

China is strategically important to Japan, in both ensuring stability close to home and providing Japan current and future markets. Support for China's modernisation plans ranks high in Japan's aid policy.

That Japan is most unlikely to turn its back on Asia in its "assumption of more global responsibilities" was reinforced just before the opening of the 20th ADB annual conference in Osaka on 27 April by the announcement that the Eximbank, with the World Bank, would lend the Philippines US$300 million. These are the first untied loans by Japan to that country.

Some future aid to the Philippines is also likely to demonstrate Japan's growing sensitivity to the needs to the people of recipient countries over the doubtful economic ambitions of their government leaders. The Japan International Cooperation Agency (JICA), which mostly handles grant projects, early in May prosposed that Japan move from the past policy of constructing buildings and roads there to boosting farming infrastructure and techniques. About 60 % of the Philippines' population is involved in agriculture, JICA pointed out.

Japan is under constant pressure from other industrialised countries to improve the quality of its aid. The grant element in ODA loans has consistently lagged behind the Development Assistance Committee (DAC) average for member nations of the OECD figure of 73.5 % compared with the DAC average of 91.3 %. While the DAC average share of grants in ODA was 80 % in 1985. Japan's grants totalled only 47.5 % of ODA.

Calls have also been loud for an increase in Japan's untied aid, which accounted for 66.3 % of ODA disbursements in 1985. The figure drops substantially when it is taken into account that supposedly untied projects are planned according to Japanese specifications, to be picked up by Japanese business. Much behind-the-scenes negotiating occurs between Japanese companies and recipient-country governments, and incentives from the Japanese side in the form of bribes are thought to be not uncommon.

Nakasone's latest aid package will go some way towards increasing untied loans in Japan's overall aid disbursements.

THE ECONOMIC TIMES, NEW DELHI, 27 MAY 1987

The Okita plan

Third world countries nave been pressurised over their debt. Currently there is a sizable net outflow of resources (estimated at $ 30 billion in 1986–86) from the developing to the developed countries. The growth of the developing countrties has been badly depressed. It has been grudgingly admitted in recent IMF publications that growth prospects in the developed world, notably the United States, are not such as to compensate for the drop in the growth of the developing countries. The growth scenario for the developed market economics as a group has worsened in recent weeks, and with it the prospects of a reversal of resources transfer in favour of developing countries have been bleak. This is reflected in the recent rise in interest rates in the U.S. wihich has led to an accentuation of financial flows at that country. The process of intra-developed country transfer of resources stands strengthened.

In this context, consider the OECD study, released earlier this month, advocating co-ordination in the macro-economic policies of the rich countries, the key feature of which is a substantial reduction in the U.S. budgetary deficit **with** a simultaneous fiscal expansion in other countries led by Japan and West Germany. The counterpart of a reduction in the U.S. trade deficit, according to OECD, is a reduction in the trade surpluses of Japan and West Germany. This skewed approach bypasses the issue of inadequate growth for want of resources in the developing countries. It views growth purely as an intra-developed country affair. In any case, how far will Japan, for example, be able to reduce its current account surplus from $ 85 billion projected for 1987 to $ 60 billion, $ 50 billion, $ 40 billion? The overhang of the current account surpluses of Japan and West Germany will remain formidable. We have to view the Okita plan which envisages the mobilising of international surpluses for world development, against this background. The plan, prepared by three economists led by Mr. Saburo Okita of Japan (the others are Mr. Arjun Sengupta of India and Mr. Lal Jayawardana of Sri Lanka), proposes to recycle $ 125 billion of Japan's trade surplus (or less than that country's projected current account surplus for the next two years) over a period of five years to the developing countries, through an institutional arrangement involving Japan (its export bank, commercial banks and capital markets), the World Bank and IMF. About five billion dollars (annually) is earmarked for low-income countries, to be channelled through IMF and supported by an interest subsidy by Japan. The plan envisages the routing of $ 10 billion through the export bank of Japan and an equivalent amount through a Tokyo-based trust fund which will liaise with the World Bank for programme and project lending. In this plan, the dent on the flow of trade surplus to the U.S. is relatively small. But the release of even this limited volume to developing countries, notably the indebted ones, would have to be supported by interest rates policies of the U.S. The proposed involvement of IMF and the World Bank is designed to create confidence in the indebted countries and thus to lead to a resumption of lending to them by the international commercial banks. Equally imaginative is the proposal for the issuance of zero coupon rate bonds for investment by the developing countrties for use as collateral for borrowing a multiple of the amount invested in such bonds. (The initial face value of the investment would be low if the implicit rate of interest on the bonds is high and their maturity period is long). The Okita plan, designed to reverse the flow of funds in favour of the developing countries is, however, dependent on how far the rich countries, notably the United States, are willing to co-ordinate their macro-economic policies in support of it. On this hinges not only how much of the trade surplus of Japan, West Germany and other countries is freed for growth in the developing countries but also the cost of the recycled funds to them. Judging from the OECD report referred to above, it is unlikely that the rich countries will be willing to share the perception of the Okita plan, which seeks to shift the focus away from protectionism to a new regional pattern of priorities in growth.

From Citicorp to Venice

Banks sometimes hit the headlines through imprudence. But Citicorp's admission last week that debt owed by the poor countries may turn out bad could be constructive. It clarifies the bank's position for stockholders, carries a message to debtor governments and highlights what should be at center stage for the economic summit meeting June 8 in Venice.

What went wrong after the early 1970s was not the massive recourse the Third World had to funds from aboard, but the form the funds took and the use made of them. Poor countries need a large and continuing flow of foreign capital if they are to develop; they cannot base development simply on the savings of their people. Most of today's wealthy industrialized countries imported foreign capital heavily in their formative stages.

But equity capital, not straight bank loans, played an important role. It was plowed into schemes that enabled the lenders to be paid back from future profits. It did not expose borrowers to debt that fell due regardless of the state of their economy. Unfortunately, today's poor countries have had to borrow largely through loans, not equity, and in many cases have used the money to support consumption more than industrial and agricultural development.

Whether debtors can, in the future, get foreign capital in more suitable forms will depend on their ability to create conditions in which lenders see reasonable prospects for reasonable profit. This in turn depends on the sort of world economy the richer countries can create – which should provide food for thought at the Venice summit meeting.

The democracies will hardly improve the investment climate so long as, in deeds though not in words, they pursue something approaching a zero-growth option. Growth in the developed world is the prerequisite of future profit in the developing areas – without it, their exports cannot thrive. Nor will Citicorp and its fellows find it easy to improve their positions by selling existing debts at a discount or converting them into equity: The discounts could prove deep and the equity prospects unattractive.

Venice should press for two other changes. Very poor countries, particularly in black Africa, owe more to foreign governments than to the banks. The terms of this debt should be lightened, or the debt canceled: a small step for the rich but a big one for Africa. And Japan should be persuaded to take up the proposals put forward by its world-renowned economist Saburo Okita, whereby about $125 billion would be allocated by the government over five years to guarantee closely targeted new loans to the principal debtors of the world. This would far exceed the more modest, and vague, proposals made recently by Prime Minister Yasuhiro Nakasone. And it would herald, for Tokyo, a new era of international responsibility and economic sense.

In the lifetime of the average reader, the debt of many poor countries cannot be repaid; it can only be converted, at a rising level, into more suitable forms. Whether this happens depends on better policies in the Third World, and in the First. The alternative is outright default leading to economic anemia in both worlds. The problem is not to reduce debt but to increase it through more logical means.

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