OFFICIAL DEVELOPMENT FINANCE; ISSUES FOR THE 1990'S

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November 1989

This paper has been prepared for UNCTAD.

I. Introduction

To define the role for official development finance in the 1990's, it is necessary to understand first the needs which such funding have to meet, and in particular the extent to which it has to perform roles or fill gaps originating in market failure. More broadly, public financial institutions need to draw on the experience of the last two decades, and on the changing features of the world economy, to define the role which they should play both in development finance and in liquidity creation in the nineteen nineties.

In this context it is important to stress that the largest institution funding development - the World Bank - was created to compensate for the absence of a well functioning private international capital market, as private capital flows were seen at the time of Bretton Woods to have been either destabilizing and later practically non-existent. The World Bank was to serve as a multilateral long-term lending institution, to provide capital for countries with low savings and high rates of return, initially for post-war reconstruction and then increasingly for development. As Anne Krueger (1989) points out: "The rationale for the creation of the IBRD was straightforward: it was to substitute for a well functicning private capital market, since it was believed that the inter-war experience would preclude the emergence of such a private market."

Lending by the World Bank, as well as bilateral official flows assistance, were the main forms of external finance for developing countries in the post-war years. Mistry (1989a) has estimated that around 30-35% of total external capital flows to developing countries in the 1947-59 period were provided through World Bank lending. In the 1960's, multilateral development funding continued to play an important but smaller role (with the World Bank representing around 7% of total external capital flows to developing countries), and with official bilateral financing increasing substantively its share, particularly in the funding of Latin American development (see S. Griffith-Jones and O. Sunkel, 1987).

As is well documented, in the seventies, the rapidly growing private international capital markets contributed to funding developing countries' balance of payments in a major way. The role of bilateral and multilateral financing became far less central; the World Bank is estimated (by Mistry, op. cit.) to have contributed during the seventies with only around 3% of total external resource flows to developing countries.

With the virtual collapse of net private bank lending to developing countries since 1982, official flows have again increased their relative share. For example, the World Bank's contribution has grown in the 1980-88 period to a level of 9-10% of net capital flows to developing countries, a level it had not reached since the early 1960's.

The increased role for public flows and public institutions in the 1980's (which needs to continue and expand into the 1990's) is justified due to different types of limitations which private capital markets have for funding development. To the extent that in this field there is market failure (in some aspects temporary, whilst in others permanent; in some aspects partial, whilst in others total) it is essential for public entities and flows to provide valuable "public goods"; the need to attain this "public good" requires public institutions to regulate private flows, complement and encourage them and, most importantly, to replace them by public flows in areas where private markets break down or cannot deliver a service on their own (the latter most clearly in the case of funding of low-income countries at concessionary interest rates or through grants).

As the experience of the seventies and eighties again so clearly demonstrated, an important reason why private financial markets are inefficient to fund developing countries is their tendency to over-lending, followed by under-lending, and often resulting in financial crises. The 1970's and 1980's were by no means the first period of economic history in which bank lending (or other forms of private flows) have had an "euphoric" over-expansion followed by over-contraction. Kindleberger (1978) has described analytically the general pattern of boom-boost lending, as well as documenting it with historical examples throughout several centuries; Marichal (1988) describes in great detail the five great lending boom/debt crises that have occurred in Latin America since the region's Independence.

<u>The instability and the pro-cyclical nature of private lending</u> to developing countries is particularly harmful, as interest rates, terms of trade and the supply of lending tend to interact perversely, as they did in the eighties, with negative net resources transfers coinciding with low and declining commodity prices. As a result, private capital markets on their own are an unreliable and unstable source for liquidity creation and for resource transfers to developing countries.

A second limitation of private lending as a mechanism to fund development is that the terms on which these took place, particularly in the seventies (both as regards variable interest rate and relatively short-term maturity loans), were particularly unsuited to fund long-term development. It should also be stressed here that developing countries did not have much alternative, in the seventies, for different financial terms; if they wanted to borrow in the private capital markets, other options such as bonds, were not available to them, at a significant level.

Private capital markets are particularly badly suited to fund development in low-income countries, and investment in social spending, and in infrastructure, especially but not only in these low-income countries. Indeed, except for special circumstances such as the over-lending boom of the mid and late seventies, the private capital markets are unwilling to fund low-income countries. The case for international public flows in this case is particularly clear; given the uncertainties concerning yield in capital in low-income economies, the difficulty to capture commercially the economic benefits of particularly productive investment in them, (in sectors such as education), given the length of the pay-back periods, and above all, the difficulty to convert the benefits of such investment into foreign exchange to service debt in commercial terms due to the slow growth of exports, international private funding would be inappropriate, undesirable, and in any case, unlikely. Furthermore, as Mosley (1987) argues, there are potentially profitable activities in low-income countries, which their own private sector will not carry out because yields in these countries may rise significantly after projects are initiated, due both to "learning by doing" and complementary investment stimulated once the project is initiated.

As a result the case for official grants or concessional official funding for low-income countries is a particularly strong one.

The policy implications from the preceding analysis are that public institutions and flows have to replace markets where these are in practice non-existent; supplement, support and regulate these markets where they do operate, but imperfectly, to avoid instability of private flows and financial crises, whilst helping to ensure that the modalities through which private flows fund development are appropriate. This role is based on the assumption that governments of industrial and developing governments value and attach priority to development of the poorer nations (and see stable, sustainable capital flows to them as an important condition for development) and that industrial governments also attach priority to safe-guarding the stability and solvency of their financial systems, which can be threatened by boom/bust lending to developing countries. In this sense, sufficient and stable external financial flows to fund development and a stable international banking system are important "international public goods", that cannot be appropriately provided by private market agents acting individually, due either to partial or total market failure. Seen form this perspective, stable flows to LDC's and a stable international banking system are comparable to international public health activities, which if not deliberately, actively and properly pursued, will imply an explicit cost.[1]

1. A parallel can be drawn with another activity, the co-ordination of industrial countries' macro-economic policies, and in particular of exchange rate policies which increasingly is seen (for example by Kenen 1988) as an international public good. In this case, the reference to international public good

The policy implications of the preceding analysis are the following:-

1. There is a completely clear cut case for a major role for public flows, either in the form of grants or of concessionary funds, to help finance low-income countries' development.

For these countries, private external finance is, on the whole, either unavailable or inappropriate (given its financial conditions) to fund long-term development; naturally, exceptions can be valuable and welcome if the modalities used and the activities they are channelled to imply a likely beneficial effect for development (e.g. project finance for profitable investment in foreign exchange earning activity).

To the extent that domestic savings are limited in those countries by their very poverty, external savings (via public flows) can provide a valuable complement to domestic savings, particularly if accompanied where necessary by appropriate technical assistance. Though other motives are also important, the re-distributive case for aid is particularly compelling for low-income (and especially least developed) countries. It is based on the value judgement that the conditions of life available to people in these countries are morally unacceptable, and a contribution should be made by transfers of income from people who have far higher standards of living; to the extent that private channels (e.g. voluntary agencies) can carry out these redistributive functions only to a limited extent, tax-payers in industrial countries require governments to provide internationally, through aid, similar functions of income

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is not mainly to failures or gaps caused by the sum of individual private market actors, but mainly to failures or gaps from uncoordinated actions of individual governments.

redistribution that they supply domestically through a progressive income tax and spending on welfare. As Mosley, **op. cit.** suggests, aid to the low-income countries can, to an important extent, be seen as an "international public good", in the sense that it is a redistributive service desired by many which, however, cannot be satisfactorily brought into existence by the effects of individuals acting in isolation, and therefore requires actions by governments and public multilateral organisations.

2. In the case of middle-income countries there is a need for public flows and institutions to both complement and encourage flows from the private sector, as well as ensuring that the modalities used are appropriate to fund development.

The value of mixing public support and private flows for middle-income countries is well illustrated by the operation of the World Bank itself, institution which no longer requires public cash support, for usable share capital, to support its operations (except to reduce the cost of lending and to increase its financial flexibility); however, as Mistry, **op. cit.** describes, the World Bank does need the guarantee support inherent in its salable equity base to enlarge its intermediation capacity.

The mixture of public flows/support with private flows is also being developed and implemented in innovative ways by the Japanese government. Indeed, as Ozawa (1989) argues, hybrid forms of economic co-operation where joint financing is arranged by the government in collaboration with the private sector is one of the main distinguishing features of Japanese economic assistance. As we will discuss in more detail below, the Japanese approach includes joint financing arranged by the government in collaboration with the private sector, where the private institutions gather funds while public institutions serve as intermediaries to reduce the risk of channelling funds for socially useful investment projects in developing countries. In this instance, government resources are used mainly to provide some form of appropriate guarantee and - particularly in the case of low-income countries - to provide an interest subsidy, to bridge the difference between the cost of financing in the capital market and the concessionary rate of interest considered appropriate for lending to low-income countries.

The relative proportion of efforts needed directly from international and bilateral public agencies to complement, through their own flows, as opposed to encourage, private flows, will partly depend on the extent to which private international capital markets resume lending to middle-income countries. If, as seems likely, in the nineties private capital markets remain reluctant to lend to most middle-income countries (and there is thus a "temporary market failure") then the case for a greater direct role for public external flows to fund investment in middle-income countries becomes stronger. A strong supporter of free markets, Anne Krueger, op. cit., concludes similarly that "the risk that the private international capital markets will not resume normal functioning "is one of the big reasons for believing that "multilateral lending institutions will have an even more vital role to play over the next decade than they have had historically". However, to a far greater extent than in low-income countries, investment in middle-income economies should be funded from the countries' own savings efforts.

3. Even though we are concerned here mainly with the provision of official development finance as a mechanism to increase the net capital transfer of resources to developing countries, it is important to stress that international public institutions also have an important role to play in the provision of liquidity to developing countries, as the unsatisfied demand for international liquidity by a large proportion of developing countries has increased in the eighties, and is likely to remain high, as has the cost to these countries' economies if their demand is not met by the international creation of liquidity via the IMF.[2]

4. For international public institutions to channel directly and encourage appropriate levels of resource transfers and liquidity creation to developing countries, they need to start by defining minimal resource and liquidity needs of individual developing countries and for categories of developing countries, in a medium-term framework, on the basis of politically acceptable minimum growth rates and maximum realistic national efforts at domestic savings mobilisation in LDC's.

5. Finally, in response to the imperfections in the functioning of international private lending to developing countries, it is necessary that international financial institutions - such as the IMF and the World Bank - play a role in the regulation of these markets. As discussed above, if unregulated, private international lending to LDC's can often follow "boom-bust" patterns. When the slow-down of lending occurs (and particularly if it contributes to widespread debt crises as it did in the eighties), both industrial countries'

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2 For insightful discussions of this issue, see A. Sengupta (1987) and M. Camdessus (1988).

governments and international financial institutions (IFI's) are forced to intervene and devote an important part of their financial and personnel resources to moderate the negative effect of debt crises on both private creditors and LDC. debtors (thus taking these resources from their central task, which in the case of the World Bank is the funding of development). It seems essential that the IFI's, which are forced to help "pick up the pieces of debt crises" are able to make an input into the setting up of a system of supervision and regulation of private flows to ensure that these do not become excessive, and to encourage the development of modalities of lending and investing appropriate for funding long-term development, so as to avoid future debt crises so costly to all parties.

In discussing development finance in the 1980's and into the 1990's, it is inevitably necessary to analyse the link between external debt overhang and official finance.

Some positive links have emerged between development finance and the debt overhang. For example, the World Bank has made efforts to raise special funds for its Special Facility for Africa (approved in 1989), as well as attracting special funding for the Bank's African "Special Programme of Assistance", launched in December 1987. To the extent that these programmes have at least an element of additionality, and respond at least partly to the severity of the debt overhang in Africa, it can be argued that the debt problem has catalysed some additional development funding.

The main links of this entanglement however are negative. An important share of development funding (and particularly finance from the World Bank) was used increasingly since the mid-eighties to provide programme lending (through SAL's and SECAL's) to highly indebted middle-income developing countries, so as to make viable their servicing of interest to their commercial creditors. Thus, of the increase in World Bank total annual net disbursements between 1982 and 1986, (of $2.3 bn), practically all ($2.0 bn) was disbursed to Latin America and the Caribbean; if annual net flows are compared, the increase of flows going to Latin America and the Caribbean between 1982 and 1986 ($1.7 bn) was <u>larger</u> than the total increase of net flows to all developing countries.

These trends in the mid-eighties had three negative effects on the funding of development. Firstly, funding was diverted to Latin America from lending to other areas of the world, where average incomes are even lower than in Latin America, and where projects with a potential positive impact on development were thus postponed or not carried out. Secondly, a large share of the World Bank lending to Latin America was not geared to fund new development projects, but had as stated aim balance of payments support, so as to make feasible the debt rescheduling/new money packages with private creditor banks. In a context of large negative net transfers from Latin America and the Caribbean (LAC) and of the ultimate fungibility of foreign exchange, World Bank funding was largely being used to finance interest payments to private creditor banks. Thus, funds which should have been used for development purposes in other regions and/or in LAC were being diverted to help manage the external debt problem. Indirectly, the <u>ultimate use of these funds was to defend the stability and - even more controversially - the profitability of private banks, rather than to fund development</u>.

Indeed, the World Bank was trying to achieve the two "public goods" referred to above (stable funding for development and a stable international banking system) with only one instrument, programme lending. It can be argued that it achieved neither "public good" very successfully because of this entanglement and because the resources it could devote to such two large tasks were insufficient; in any case, the "public good" of private banks' stability seems to have been achieved relatively more efficiently than the "public good" of stable external funding for development, as the highly indebted countries, on the contrary, had to use part of their domestic savings to fund debt servicing.

A third negative effect of the entanglement is relevant for the late 1980's and will continue as a problematic issue into the 1990's. Since 1987, the multilateral development agencies were transformed from being contributors to the solution of the debt overhang in Latin America to being part of the problem! As the level of debt owed by these countries to the World Bank - and the IADB - increased, so did amortization and interest payments to them. As a result, net resource transfers from Latin America in 1987 were negative to the World Bank (by around -$0.5 bn) and to the IADB (by around -$0.1 bn). These figures deteriorated further for 1988 and are projected by the World Bank and others (see Feinberg 1989) to continue at least into the early 1990's. For some individual large Latin American countries, the negative transfers to the World Bank in 1988 have been very high, reaching -$672 mn for Brazil and -$191 mn in 1988.[3]

3 See World Bank, "World Bank and IDA: Net Transfers to All Borrowers" November 1988.

With the Brady Plan, the World Bank - and the IMF - will continue their entanglement with the private debt overhang, (which is problematic), although in a context of debt/debt service reduction (which is an important positive step).

Ideally, it would be better to separate funding for development (e.g. via the World Bank) from industrial government funding for facilitating debt/debt service reduction to private banks; the separate public funding of such a debt restructuring facility has been suggested by a number of proponents including Felix Rohatyn, Peter Kenen, James Robinson, Rep John La Falce, Sen. William Bradley and Percy Mistry. Though conceptually correct to separate such a facility from the institutions that fund development, it may be politically unviable to achieve such a separation. In such a context, three issues seem key for the 1990's. How, and through what mechanisms, can negative net transfers from highly indebted developing countries to multilateral agencies best be eliminated and. preferably, reversed? Secondly, if funds from industrial governments and/or multilateral agencies are used to enable debt/debt service reduction, to private banks, through what modalities can such funds be used most efficiently; efficiency in this context would imply maximum debt/debt service reduction, per unit of industrial government funding and maximum development impact of the achieved debt/debt service reduction. A third, and more controversial, question also needs to be asked; to what extent should industrial governments and multilateral agencies get involved/and contribute resources to ensure debt/debt service reduction to private creditors? Can similar results not be achieved, if the commercial banks accept (or are forced to accept by the new circumstances, combined with some pressure from industrial and developing country governments) lower debt/debt service payments, without so much comfort, guarantees and funding from public sources to them as is being contributed by the Brady Plan. In such a case, public funds could be concentrated on granting some further lightening of the debt owed to governments and multilateral agencies (either via relief or via prolonged grace periods) and particularly such public funds would be used to finance new public lending for new investment and/or better use of existing capacity.

Conceptually the need for public flows/guarantees to encourage debt/debt service reduction arises from two assumptions. The first one is that public funds are required to assure the "international public good" of banking stability, and avoid the high costs of banking instability. However, by early 1989 there was practically total consensus that the Third World debt no longer posed a threat to banks' stability, due to high level of provisions and other measures. In these circumstances, public funding would seem mainly geared to defending private banks' profitability. The justification for using public funding for development to increase banks' profitability, seems somewhat doubtful, particularly in those cases where reduction of the debt/debt service to private creditors achieved is relatively modest.

The second assumption on which the need to provide public funding or guarantees for debt/debt service reduction is based is the need (in the context of the Brady Plan) for these operations to be "voluntary". If, as many observers have begun to suggest, debtor governments defined with multilateral agencies a maximum level of debt/debt service to private banks consistent with minimum growth of their economies, then this level would have to be accepted by the private creditor banks, with no or little recourse to public funds for guarantees. Mechanisms could be used (e.g. via Article VIII 2(b) of the IMF. Articles of Agreement) to limit remittance of interest income, to a level approved by the IMF, via an approval of exchange controls for debtor countries, that have agreed an IMF adjustment programme with debt/debt service reduction included in it[4]; as a result, the level of public funding for guarantees could be significantly diminished or possibly even eliminated, thus freeing resources for international public funding of new investment and/or greater use of existing idle capacity.

However, in cases where relatively small amounts of public funds (e.g. Costa Rica and Bolivia) can achieve very significant reductions of private debt/debt service, such public contributions to a substantial and rapid reduction of the private external debt are to be welcomed.

II. Implications of external imbalances and co-ordination among OECD. countries for flows to developing countries

Before examining issues of official development finance, it seems important to put these in the broader context of global capital flows, with particular relation to external imbalances and co-ordination among OECD. countries. Indeed, issues of international macro-economic co-ordination, of net resource transfers (and of international liquidity) have each been extensively analyzed in the 1980's both in the academic literature and in the debates of policy-

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4 See, for example, J. Williamson (1989) and R. Devlin (1989).

makers. It is surprising, however, that a crucial area has been almost totally ignored: the overlap between macro-economic co-ordination, net resource transfer (and international liquidity) particularly but not only as they affect developing economies.

Macro-economic policies of the major industrial countries' (and their co-ordination or lack of it) have a very strong influence on the nature and magnitude of resource flows to developing countries. This was perhaps most vividly illustrated by the effects of industrial countries' macro-economic policies in the late seventies and early eighties (both directly, via interest rates, and indirectly - via bankers' perceptions of LDC credit-worthiness) on capital flows to and from developing countries. One of the reasons why public multilateral institutions (and especially the Bretton Woods' institutions) should be intimately involved in the process of industrial countries' macro-economic co-ordination is precisely to evaluate and attempt to influence their impact on financial flows to and from developing countries. As pointed out above, in the 1980's, public financial institutions spent much of their financial and professional resources on managing and containing the international debt crises; it would have been far more efficient from the point of view of those institutions - and more broadly, for the development process - if the Bretton-Woods institutions could have been able to exert influence on individual industrial countries (and on the aggregate of their actions) earlier to help avoid, or at least diminish, the gravity of the debt problem in the first instance.

Either if one approaches the issue from the perspective of their effect on resource transfer (and liquidity) needs for developing countries or from the perspective of the relative weight of exchange rate system since the Plaza Agreement in 1985, and particularly since the more ambitious Louvre agreement in 1987, which seemed to imply an agreement by the G-7 finance ministers to fairly precise "reference ranges" for their exchange rates. Furthermore, the discussion of a system of co-ordination of developed countries' policies has moved beyond focussing exclusively on exchange rates to the broader issue of macro-economic management; however, no formalized agreement on an analytical and procedural framework has yet been developed, though there seems to be somewhat of an emerging concern in this area at a technical level (see below).

Two important areas of concerns have emerged in the economic literature, which are increasingly reflected in discussions among policy-makers. The first is that greater fixity in exchange rates can only be brought about efficiently by providing also for some co-ordination of macro-economic policies among industrial countries.

As industrial governments do not yet wish to participate in a system of completely pegged, exchange rates, they are exploring ways of imposing exchange-rate management without at first reforming exchange rate arrangements, and have therefore emphasized policy co-ordination. Industrial governments now again accept that, by controlling their own monetary and fiscal policies, they can attempt to manage exchange rates. Kenen (1987) therefore concludes that industrial governments see multilateral surveillance as the framework for achieving the necessary changes in national policies. A further important step is that developing country governments and also increasingly industrial governments are not just interested in consistent policies (so as to achieve greater exchange rate stability), but are also concerned with improving <u>quality</u> of policy as well.

The objectives of both quality enhancing and consistent macro-economic policy co-ordination are perhaps most clearly set out in Williamson and Miller (1987); "the primary objective of international macro-economic policy coordination is the achievement of as high a level and rate of growth of output in the participating countries, and indeed the world as a whole, as is possible on a sustained basis. Policy co-ordination should help each country to achieve their objectives by presenting rules that are both helpful to itself and to ensure that when its' major partners follow similar rules the result is a set of mutually consistent policies".

A body of literature has emerged to support the rationale for, by pointing out the benefits of, policy co-ordination in an inter-dependent world. Coordination can be viewed ~~One strand views co-ordination~~ as the logical extension of an optimizing process by which national governments pursue their policy objectives: from this point of view, policy co-ordination serves to internalize the effects of economic inter-dependence that no single government can capture on its' own. Following this approach, Sachs and McKibbin[6] have reported that special benefits would be obtained by developing countries; indeed, their study reported that developing countries would be the main beneficiaries of co-ordination among industrial economies, even if industrial countries only took account of their collective self interest in deciding their policy actions.

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6 Sachs J. and J. McKibbin, (1985) "Macro-Economic Policies in the OECD and LDC External Adjustment." <u>Brookings Discussion Paper no. 24</u>, December 1985.

Another strand (the public goods approach) views policy co-ordination as the process by which governments pursue commonly agreed or collective objectives and defend the international economic system from economic and political shocks. This argument is based on the assumption that individual governments acting alone - and pursuing their own national objectives - would not necessarily be able to achieve commonly shared objectives, such as sheltering the international economic system from major economic or political shocks. The "international public good" of developing and enforcing rules for assuring a stable and growing world economy was previously performed by the US; as the US seems to lose relative importance (and influence) and no other power replaces it completely, the task should be carried out by a collective of governments.

A second area of emerging consensus in the literature, relates to the nature of explicit rules or guide-lines which would provide most benefit to the world economy in terms of superior performance. Such an emerging consensus on a blueprint for co-ordination is crucial to policy-makers as it provides a concrete basis on which to start acting.

A very important step in developing such a blueprint for international co-ordination is the framework designed by Williamson and Miller, op. cit.. Building on their own earlier work on exchange rate target zones and on the work of Nobel Prize Winner James Meade (1984) and others, on treating the growth of countries' nominal income as an intermediate target, Williamson and Miller designed a set of rules for the conduct of monetary and fiscal policy in the major industrial countries that would stabilize both real exchange rates and nominal demand growth. A summary of the Williamson and Miller blueprint can be found in Figure 1.1.

Though there are some important critiques of the Williamson-Miller framework and some broader areas of disagreement, the Williamson-Miller blueprint does seem to crystallize an initial emerging consensus on which international policy coordination could be built.

From the point of view of developing countries, the Williamson-Miller blueprint, has an important direct advantage in that it targets the average level of world (real) short-term interest rates, a crucial variable for LDC's, as excessively high levels of interest rates in the 1980's have been a major cause for lower LDC performance[7].

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The Williamson-Miller blueprint is also interesting in that some of its proposals coincide with arrangements de facto made by industrial governments for a far more structured exchange rate system than had existed since 1973, (the previous work of economists like Williamson, Kenen and others provided an important theoretical underpining for movement towards more structured exchange rate management) while another part of its proposals go beyond what has already been agreed, and implemented by industrial governments. Industrial governments agreed in February 1987 (the Louvre Accord) to rather precisely defined "reference ranges" for their exchange rates. Though industrial governments have endorsed more ambitious aims of

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7 See, S. Griffith-Jones, (1989) "International financial and monetary reform; a developing country perspective", forthcoming South Commission Discussion Paper.

institutions (particularly, but not only the IMF) to play. This role includes improving the quality and broad acceptability of their projections of economic variables, both for the major countries and the world economy, and improving understanding of how policy changes affect the economy of the country concerned and other countries' economies.

The discussions amongst the G-7 governments on policy co-ordination initially focussed to an important extent on the issue of whether to rely on the governments' own numbers or those provided by the IMF. It would be far more desirable for the IMF's figures and forecasts to be used. Furthermore, this not only enhances the Fund's role in the actual analysis of policies, but <u>also increases its ability to speak for countries that consume the public goods produced by policy co-ordination, but in the near future are unlikely to participate in its production, the developing countries</u>. The participation of the World Bank in this process - both at the level of production of figures and of evaluation of inter-action between policies and economic variables-would be valuable <u>both</u> in adding a more long-term dimension <u>and</u> helping to focus far more on development concerns, including the crucial issue of long-term net resource transfers.

A second - more normative - problem precisely relates to issues of capital flows, thus again presenting both a problem and an opportunity for the public international institutions.

As Kenen (1988) and others have correctly argued, a definition of equilibrium exchange rates requires a previous definition of an appropriate set of current account balances, which in its turn requires defining appropriate capital flows. This is an area of crucial interest, not just for industrial but also for developing countries, and for actors involved in funding development. The net flow to and from the groups do need to make sense from a global stand-point . This is technically difficult, in a world of changing investment opportunities, capital controls, unclear guarantees for international property rights and largely fluctuating fiscal policies. However, it is essential for the current work of the IMF and the World Bank in developing countries to have some estimate of future private flows to and from developing countries, so as to help define their own flows and help define desirable official flows from other sources, either multilateral or bilateral. If such an estimate had existed in the early eighties (and it had been accurate), then the resulting net resource outflows for much of the developing world could have been forecast, and hopefully influence could have been exerted on industrial countries governments to avoid policies that would have led to such an undesirable result; alternatively, if this attempt was not successful, the international public institutions should have immediately started (as a second best) to design policies that would moderate net private outflows from large groups of developing countries and design mechanisms to channel official resource transfers, and liquidity flows, to them, to compensate for the negative private net flows. Similar exercises, would need to be carried out in the future. Two important issues to be considered in this context at present are: i) the links between continued US current account deficit and its financing (largely by Japanese savings) with flows to and from developing countries, and - an emerging issue - ii) the link between increased flows from market industrial countries to European "socialist" or formerly socialist countries and flows to developing countries. More generally, such exercises would firstly test the internal consistency of the different policies to be pursued by the major industrial countries (including both the sustainability of capital flows within the industrial countries and the consistency between planned monetary and fiscal policies and projected capital flows). It would also - and this is a step not highlighted in the current discussion of macro-economic coordination - need to evaluate the consistency of the likely resulting current account results and capital flows with minimum needs of resource transfers (and liquidity) of different categories of developing countries. The Bretton Woods institutions would not only contribute to elaborating the numerical and analytical framework for modelling and providing technical assistance in negotiating policy coordination among industrial countries, but also provide the analytical bridge with the needs and trends of the rest of the world, and particularly the developing countries. De facto, no other institution can provide this bridging role better than the Bretton Woods institutions, particularly if they are supported by other international institutions, (such as UNCTAD) which specialise in developing country issues.

A natural division of labour would seem to emerge between the Bretton Woods institutions, based on their comparative advantage, experience and mandates. The IMF would act mainly as a technical secretarial on issues of policy coordination amongst industrial countries, as well as exercising surveillance over industrial countries and determining liquidity needs of different categories of countries (including developing ones). The World Bank would focus more on determining the net capital resource gap of different categories of LDC's (and of LDC's as a whole), based on socially acceptable minimum growth rates in them. The World Bank would thus be more directly concerned with capital resource needs, while the IMF would integrate both its' own concerns for the liquidity needs of developing countries and the World Bank's concerns on resource transfers with the analysis and coordination of macro-policies in industrial countries. However, given the importance of the World Bank's input, it too should be represented in the discussions of industrial countries' macro-coordination, and should do analytical work on the subject, with the point of entry to its work being the resource flow and growth needs of different categories of developing countries.

The efforts at macro-economic coordination would thus inevitably be linked to projections, analysis and action on recycling of private and public flows from surplus to deficit countries, and from developed to developing countries. If the link is not carefully made, both analytically and in terms of changes in policy, co-ordination among industrial countries could improve their own policy performance - and offer some valuable indirect benefits to the developing world - but risk that in the nineties the underlying negative trends that have emerged in the eighties in financial and trade links between developed and developing countries would not be tackled; the IMF, the World Bank, as well as other international institutions, should play an essential role, by explicitly attempting to integrate development concerns and issues into the process of policy co-ordination.

III. The recycling of Japanese surpluses to developing countries; some comparisons with other industrial countries

In the short and medium-term, one of the potential concrete links between resource transfers to and from developing countries with the conduct and coordination of industrial countries' ma -economic policies clearly emerges in the recycling of su

There is broad acceptance in the development literature that net resource flows should go from capital abundant to capital scarce countries where the social marginal productivity of those countries would be high. Therefore, a well coordinated international economic policy would include - among its' targets - the generation of net current account surpluses in the aggregate of industrial countries to facilitate resource transfers to developing countries. In that sense, the argument often made that the current account surplus of industrial countries that are characterized by rapid export expansion and high rates of domestic saving should be <u>reduced</u> seems incorrect.

Furthermore, policy coordination among industrial countries has almost entirely focussed on attempting to reconcile imbalances only among industrial countries, in an attempt to match surpluses of some of them with others' deficits, leaving as a result, scarce resources available for them to flow to the developing countries. Particularly, initially, efforts at policy coordination amongst the major industrial countries has, in general, <u>not</u> included as one of their joint objectives the function of a net positive current account within their group, nor even less have they focussed on the design of appropriate mechanisms for intermediating these surpluses towards productive investment in developing countries.

However, at recent G-7 economic summits, the Japanese government has unilaterally announced fairly important funding initiatives for developing countries. Thus, at the 1987 Venice summit, the Japanese government pledged to supply developing countries with not less than $20 billion in untied funds for the next three years; this was additional to the $10 billion in untied funds pledged the previous year to the IMF, World Bank and other IFI's. Adding recycling, ODA, and private direct investment (and discounting for overlaps), Okita (1989a) estimates the total flows from Japan to developing countries at around $25 bn per year in the 1988-89 period. At the Paris 1989 summit, a further increase of Japanese capital recycling was announced by expanding the existing programme "of more than $30 bn over a three year period into a programme of more than $65 bn over a five year period", (for details, see below, in particular Table 4).

A. DESCRIPTION AND EVALUATION OF JAPANESE RECYCLING

As recycling of Japanese surpluses has increased so rapidly, as a number of separate initiatives have been taken by the Japanese government in a short period, and as initial statements by the Japanese authorities have been somewhat general, and in some instances perhaps even unclear, it seems useful first to describe and evaluate recent trends in this recycling, both as regards amounts, mechanisms used and distribution of flows; this analysis will also include some comparison with the performance of other industrial countries, to put the recent rather impressive Japanese performance into a broader perspective; this seems particularly relevant as Japanese substantial efforts in the aid and particularly the recycling fields are too often received with criticism rather than with the recognition they clearly seem to deserve. In later sections we will examine the particular mix and links between public and private mechanisms that characterise Japanese flows and attempt to draw some lessons from trends in Japanese flows for other industrial nations.

In evaluating Japanese flows to developing countries, an important distinction is whether analysis of Japanese co-operation is based (as traditionally occurs) strictly on official flows - and particularly on ODA - or whether a broader concept of flows is used, to include both public and private flows. Japanese analysts themselves, like for example Tanaka (1988), Okita (1989a), Okita (1989b) and Ozawa (1989) prefer the latter, broader concept, which they call "comprehensive economic co-operation" (or "minkatsu"), and in which they include not only official flows, but what the Japanese analysts call private sector and hybrid co-operation, which incorporates export credits, private loans and private direct investment. We will start with the latter, broader context and then look at ODA. flows.

As can be seen in Table 1, the 1987 figure of total Japanese net capital disbursements (both public and private) to developing countries is **very high, reaching 22.5 bn dollars**; it is **by far** the highest figure if compared with flows from other developed countries. In particular, it is **almost twice** the level of **net disbursements** from the **second** biggest contributor of total flows, **the USA**, which reached 13.2 bn dollars in 1987! Japanese total net disbursements are also in particularly sharp contrast with those from some industrial countries (e.g. Switzerland and Belgium), which in 1987 had total negative net disbursements of capital flows to developing countries.

Table 1: Comparison of aid and non-aid flows (million dollars and %), 1987[1]

Net disbursements	Japan	U.S.A.	West Germany	Netherlands	Canada	United Kingdom	Italy	Sweden	Australia	Belgium	Switzerland
I. ODA											
Amount	7454	8945	4391	2094	1885	1865	2615	1377	627	689	547
% of GDP	0.31%	0.20%	0.39%	0.98%	0.47%	0.28%	0.35%	0.88%	0.33%	0.49%	0.31%
II. Total Official and Private Flows											
Amount[2]	20349	13193	8843	3217	2482	3430	2019	1756	920	-309	-1618
% of GDP	0.85%	0.29%	0.79%	1.50%	0.62%	0.50%	0.27%	1.13%	0.49%	-0.22%	-0.91%

(1) Source: Based on data in DAC, Development Cooperation, December 1988. O.E.C.D. Paris and DAC Development Cooperation in the 1990's, O.E.C.D., Paris, December 1989

(2) Total flows include O.D.A., non-concessional official flows, private sector donations and private flows at market conditions.

As a percentage of GDP, total Japanese net capital flows in 1987 were also amongst the highest of the industrial world (at 0.85 per cent of GDP, which compared very favourably with 0.29 per cent of GDP. for the USA, -0.22 per cent for Belgium and -0.91 per cent for Switzerland). It should however be stressed that other smaller industrial countries have higher total net capital flows proportionally to their GDP than Japan (e.g. Netherlands at 1.5 per cent and Sweden at 1.1 per cent). Furthermore, as can be seen in table 1, the net capital disbursements from Netherlands and Sweden are mainly on concessionary (ODA) terms. In the Japanese case, only about a third of the total net capital flows to developing countries is in the form of ODA, ratio which is far higher for most other countries (see again table 1).

Another interesting feature (see table 2) of total Japanese net disbursements of capital flows is that they have grown very rapidly (in US dollars) since the mid 1970's. As proportion of GDP, those flows have remained relatively constant, with a slight tendency to decline in recent years; this is partly due to high growth of the Japanese economy and partly due to the rapidly increasing value of the Yen. Rapid growth of total Japanese net capital disbursements (measured in US dollars) is in very sharp contrast with the evolution of other industrial countries, where particularly since 1984 net flows have fallen very sharply; as is clear in Table 2, total net disbursements from the USA fell sharply between 1984 and 1987, with some small recovery in 1988; in the case of the UK 1987 total net disbursements are well below 1984 levels, and even further below 1976-78 levels. More generally, DAC. total official and private

Table 2: Evolution of Japanese ODA and other DAC flows to developing countries

($ million and %)
and comparison with selected industrial countries and DAC total

Net disbursements	1976-78 average	1984	1985	1986	1987	1988
Japan						
ODA						
Amount	1582	4319	3797	5634	7454	9134
% of GDP	0.21	0.34	0.29	0.29	0.31	0.32
Total official and private flows						
Amount	6747	11746	11619	14578	20349	21424
% of GDP	0.92	0.93	0.87	0.74	0.85	0.75
Memo Items:						
Total official and private flows						
U.S.A.						
Amount	13658	28585	1816	18231	13193	17505
% of GDP	0.70	0.78	0.05	0.43	0.29	0.36
West Germany						
Amount	6389	6507	5749	7889	8843	11811
% of GDP	1.19	1.05	0.92	0.88	0.79	0.98
United Kingdom						
Amount	7907	4831	2463	6697	3430	2952
% of GDP	2.95	1.13	0.54	1.21	0.50	0.36
DAC						
Amount	n.a.	79103	45163	68844	65743	n.a
% of GDP	n.a.	0.99	0.53	0.66	0.55	n.a

Source: Based on data in D.A.C. Development Cooperation, Dec. 1988, O.E.C.D. Paris and DAC Development Cooperation in the 1990's, December 1989, O.E.C.D, Paris flows in 1987 were well below their 1984 level, both in nominal terms and as per cent of GDP.

The key points emerging from Table 2 are **the extent to which total Japanese net capital disbursements to LDC's have increased since the mid-70's and the extent to which this trend in Japanese flows seems to differ from general industrial countries' trend, which flows in the opposite - and downward - direction.** (It is noteworthy, however, that, at least in nominal terms, the other major surplus industrial country, West Germany, has increased total net flows since the mid-1970's, though far less than Japan; Germany's flows to CDC's, as a share of its GDP, have in most years analysed remained higher than the Japanese share).

These trends seem to provide a useful context in which the new recycling initiatives launched by the Japanese government (in 1986, 1987 and 1989) can be analysed, and an evaluation made of how much additional flows to developing countries they have and particularly will in future represent.

Before examining a part of one of the new major Japanese recycling initiatives in some detail, we will complete this brief evaluation of Japanese flows to developing countries by looking at ODA. flows on their own.

The first point is that Japanese ODA, as per centage of its' GDP, is still rather low (at 0.3 per cent in 1988, it is **below the DAC. average** in that year and well below the UN target).

However, Japanese aid has been growing and is programmed to continue doing so. Indeed, in 1987 net ODA disbursements increased by 14 per cent in real terms; the average annual rate of real increase in the past 5 years was close to 6 per cent. Furthermore, Japan has been **the major contributor** to the growth of total DAC aid in the past decade. In mid-1988, the Japanese government approved a new Fourth Medium-term Target for ODA that calls for efforts to at least double the ODA half decade total from $25 bn in the 1983-87 period, to at least $50 bn in the next five year period, 1988-92; this would imply Japan reaching or exceeding the DAC average for ODA as proportion of GDP. Senior Japanese government spokesmen have also expressed as a target that Japanese ODA becomes higher than US ODA in the near future, thus transforming Japan into the largest donor amongst the industrial countries.

Returning to the broader concept of recycling, it seems useful to examine in some detail how it operates (in particular examining the public/private links) and what the destination of such flows is. For this purpose, we will look at the performance of the $20 bn recycling initiative announced by the Japanese government in May 1987, detailing more the flows generated jointly by private banks and the Export-Import Bank of Japan.

In Table 3, Figure 1 and Appendix 1, we can appreciate details about the 20 bn dollar recycling initiatives' implementation. Appendix 1 provides details of total commitments by country and by projects of all untied loans made by the Export Import Bank of Japan to developing countries (in the context of the 20 bn dollars recycling plan), commitments which up to October 1989 reached a total of 7.7 bn dollars of loans and 3.0 bn dollars as a direct contribution to the Enhanced Structural Adjustment Facility (ESAF) of the IMF.

Table 3

Breakdown of $20 billion recycling program

1.	Government contributions and additional subscriptioons to World Bank, ADB & IDB, etc. and private capital cooperation	= $8 billion
2.	Expanded co-financing by OECF, the EIBJ, and Private banks with World Bank, etc., as well as supplemental OECF policy support loans to the developing countries	= $9 billion
3.	Expanded direct untied financing from EIBJ	= $3 billion
	3 year total	= $20 billion

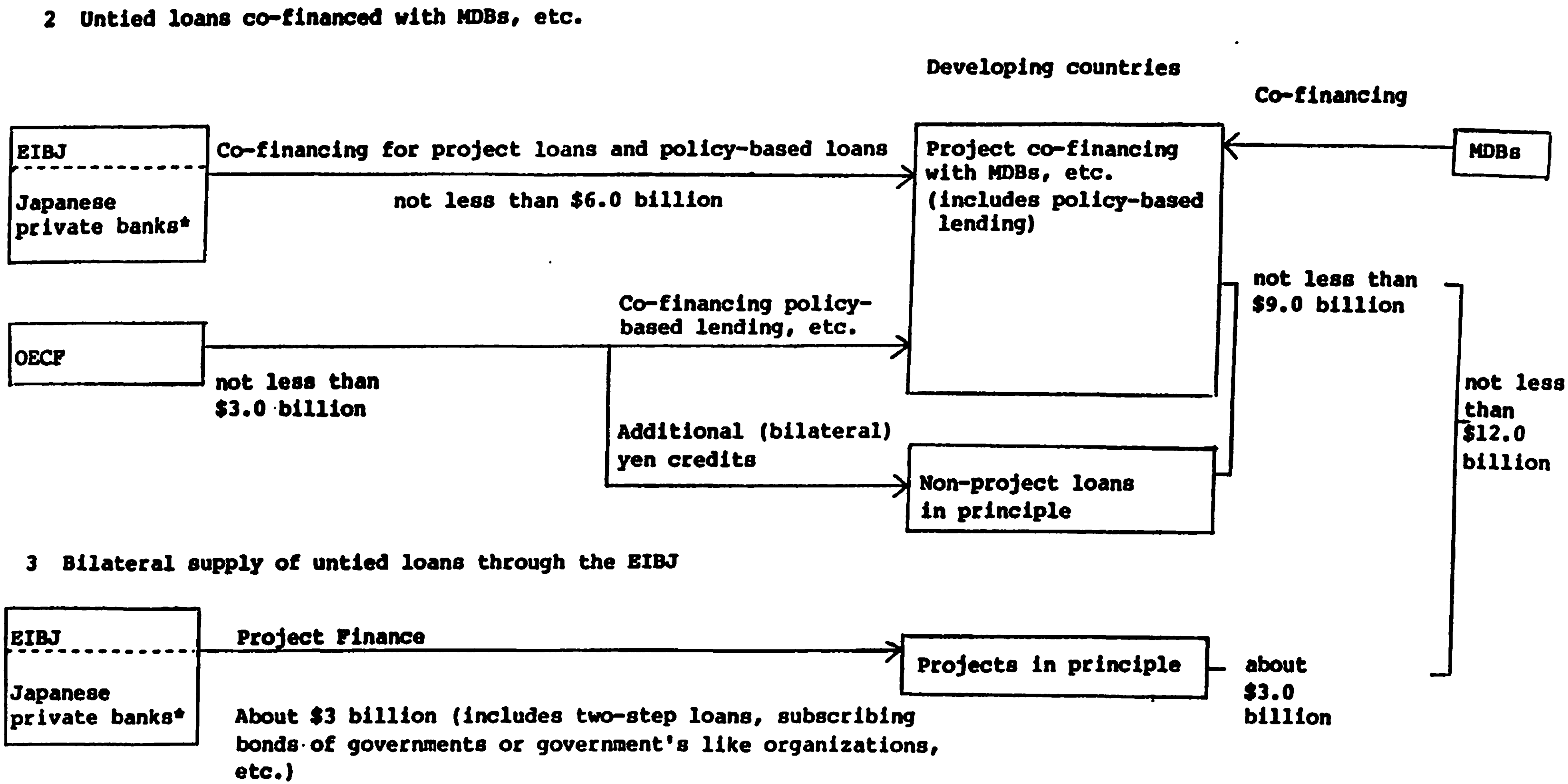
(Added to the previously announced $10 billion, the three-year total comes to not less than $30 billion.)

Breakdown of $10 billion recycling programme

a.	Establishment of World Bank Japan Special Fund	= $2.0 billion
b.	Lending to IMF	= $3.6 billion
c.	Subscriptions to MDBs (IDB and ADF)	= $3.9 billion

Source: T. Kinoshita, Japan's Current "Recycling Measures": It's Background, Performance and Prospects, September 1988. EIBJ mimeo. September 1988. Mr. Kinoshita is Senior Adviser of the EIBJ (Export-Import Bank of Japan).

Figure 1. Flow of Direct Loans to Developing Countries: Categories 2 and 3 of the $20 billion Recycling Measures



* Included in the total when there is simultaneous (co- or parallel) financing by Japanese private banks to the same borrower.

Source: Kinoshita, op.cit.

As regards the $7.7 bn, already committed by EIBJ, it is interesting to note that, according to calculations based on Appendix 1, 25 per cent of the amount committed went to Latin American countries, and 50 per cent of the commitments went to Asian countries, with the rest going to the Middle East and other regions. A shift can be appreciated from almost exclusive concentration of Japanese flows in the past to Asian developing countries (and particularly neighbouring ones) to quite a large emphasis on lending to Latin American countries and, within Asia, to growing focus on non-neighbouring countries, such as India in particular.

Three other interesting features arise from examining the information in Table 3, Figure 1, and Appendix 1. Firstly, it is noteworthy that so much of the Japanese recycling takes the form of co-financing with multilateral development institutions (including both programme and project lending with the World Bank and contributions to IMF facilities). Secondly, even when we are discussing loans from the Export-Import Bank of Japan, these are completely untied. This not only provides greater flexibility to developing countries for purchasing in international markets, but also allows potentially for those recycling measures to indirectly have positive effects on industrial countries (like the US) which have a large trade deficit. Indeed, emphasis on recycling Japanese surpluses to developing countries is not just of interest to those countries, but is also a powerful indirect way to reduce the US trade deficit, without deflationary consequences for the US or the rest of the world. This is particularly true if the recycling will be channelled to Latin America, (see discussion and figures above) given that Latin America is a natural market for US exports. In this respect, it has been argued that channelling Japanese surpluses to, for example, Latin America would produce a larger gain in US exports than using these savings to further higher investments in Japan would do. There is a treble logic in channelling increased Japanese (and West German) surpluses in an important proportion to developing countries, rather than to expand growth further in the surplus countries. The former scheme has important positive-sum game elements as it favours the interests of developing countries, that of the US and that of the global economy. Furthermore, it favours a more equitable and balanced pattern of growth in the world economy, as well as reducing further the risk of vicious circles of stagnation and debt moratoria in the developing world. The recycling of Japanese surpluses to developing countries can offer profitable returns to Japanese savers, a reduction of the US deficit without contractionary effects on the US economy, much needed additional resources to developing countries and, as a result, a non-inflationary expansionary effect on the world economy. It could also be said that three different under-utilised pools of resources are being productively used: Surpluses of excess savers, under-utilised capacity and unemployed capacity and unemployed capacity in industrial countries, especially the US, and unemployed or underemployed manpower in developing countries would be combined to increase output.

Such a desirable global circuit of capital requires that the additional recycling of Japanese flows is not tied to the sale of Japanese exports, and that already existing recycling of ODA flows be increasingly untied. It is encouraging that the $30 billion recycling programme announced in 1986 and 1987, as well as its' recent expansion, is, as discussed above, untied from Japanese exports. Furthermore, an increasing share of Japanese ODA commitments are untied. Recycling via the private sector - and particularly via foreign investment - would tend on the other hand to have an implicit tied component.

Finally, it is interesting to see how new Japanese lending (both through multilateral and bilateral channels) combines public and private flows. (Indeed, of the $7.7 bn of loans to LDC for which details are provided in Appendix 1, $1.8 bn are loaned by Japanese banks).

With the purpose of providing more complete and up-to-date information, Table 4 is included to give details of the role to the Export-Import Bank of Japan and other institutions in the new (July 1989) Expanded Recycling Programme, which implies commitment of $65 bn for 5 years (for the 1987-92 period, thus including and expanding the previous $30 bn, 3 year programme). This new initiative implies an even greater emphasis than in the past for lending to heavily indebted countries, in the context of the Brady Initiative, with $4.5 bn being loans to be made by the Export-Import Bank of Japan jointly with the IMF and $5.5 bn, being co-financing by the Export-Import Bank with the World Bank and others, totalling around $10 bn for countries entering the Brady Initiative.

As can be seen in Table 4, additional funds (of $35 bn) will be distributed via: a) $13.5 bn (through the EIBJ, via parallel co-financing with the IMF and other institutions); b) $7.0 bn (through OECF) and; c) $14.5 bn (through the governments direct contributions to multilaterals and incremental private flows resulting from

Table 4: Summary of "Old" (1987) and "New" (1989) Recycling Initiatives

1. The Role of the Export-Import Bank of Japan in the Fund Recycling Programme - Old and New

A. Achievement Under the Old Programme:

(1)	Committed in Project/Programme Loans	Appx. $7 billion*
(2)	Committed to the Enhanced Structural Adjustment Facility of the IMF	Appx. $3 billion*
(3)	Total	Appx. $10 billion*

* Precise figures in Appendix 1

B. Envisaged as Incremental in the New Programme (July 1989)

(1)	Commitments in Non-IMF Co-financing	Appx. $9 billion
(2)	Commitments in Parallel Co-financing	Appx. $4.5 billion
(3)	Total	Appx. $13.5 billion

C. Grand-Total Under the Total Enhanced Programme: Appx. $23.5 billion

2. Other Components of the Enhanced Programme

(1) The OECF, which has an estimate of $5.5 billion as the achievement under the existing programme, will undertake approximately $7 billion in addition, $2 billion of which will be related to the New Debt Strategy (so-called Brady Plan)

(2) The Government's direct contributions to the multilateral development financing agencies and the incremental private flows, as the result of the Government's encouragement, is in the old initiative estimated to amount to appx. $14.5 billion, and another $14.5 billion will be additional.

Source: Announcement by Japanese Chief Secretary of the Cabinet, 11 July, 1989.

government encouragement). Again here we see the mixture of official and private flows, some of which we examine in the next section.

B. THE MECHANISMS OF JAPANESE HYBRID ECONOMIC COOPERATION

As seen above, there are really three components in what the Japanese government identifies as economic cooperation: budget determined official flows, market constrained private flows and, in between, so-called hybrid flows.

The category of hybrid flows is joint financing arranged by the government in collaboration with the private sector; this is a unique factor of Japan's economic assistance, that most sharply differentiates it from other industrialized countries. Hybrids are best exemplified by cooperative loans organised by the Export-Import Bank of Japan and Japanese commercial banks and by joint loans and syndicated equity investment arranged by Japan's Overseas Economic Cooperation Fund (OECF) and private contributions for investment projects in developing countries.

As Ozawa (1989) points out, hybrid flows are a semi-privatised or quasi-public form of surplus fund recycling, as in the process private and public institutions are mutually dependent and collaborative in supporting each other's functions. Private institutions are capable of gathering funds efficiently, while public ones serve as intermediaries to reduce the risks of channelling funds for socially useful investment projects in developing countries. Thus, the hybrid approach is designed to redirect some of the profit motivated private flows into a policy guided, publicly desirable direction by using official flows as inducement.

The hybrid nature of these flows goes even one step further as the funds lent by the official institutions such as the Export-Import Bank of Japan and the Overseas Economic Competition Fund draw to quite important extent from the resources of the Zaisei-Toyushi, the government's Fiscal Investment and Loan Programme (FILP), whose resources amounted to around $150 bn annually (Okits, Jawardena and Sengupta, 1987). The FILP absorbs post office savings and other flows originating in the private sector; indeed, Ozawa, **op. cit.** estimates that nearly one-third of the nation's total savings is captured by the Japanese government in the form of postal savings accounts held by private households. Indeed, the Japanese postal savings system, representing 32 per cent of total deposits in the Japanese financial market in the early 1980's, is really "the world's biggest bank"; it is for example larger than the whole Japanese banking industry! The funds collected through the postal savings systems, as well as through other similar savings institutions, such as the Postal life Insurance and Postal Annuities and the National Old Age Pension Funds, are placed with the Trust Fund Bureau of the Finance Ministry, which in turn allocates the funds for national policy purposes. Out of this pool of funds (largely originating from private savings and channelled through public institutions) Eximbank and OECF receive special loans. As there institutions tapped a relatively small proportion of these flows, there was an important scope for expansion (Okita, Jawardena and Sengupta, **op. cit.**), which seems partly to explain the rapid expansion of lending through the Eximbank and OECF, and would seem to allow still further expansion, should the Japanese government wish to channel funds in this way. Though as the Japanese government correctly points out, these surplus funds are in the hands of the private sector, the fact is that a major proportion of such surplus funds are both collected and controlled by the Postal Savings System and placed with the Finance Ministry's Trust Fund.

Returning to the forms which hybrid economic cooperation takes, it is useful to distinguish flows from the OECF and the Export-Import Bank.

The OECF, Japan's largest dispenser of official economic aid, generates both budget-determined official flows and hybrid flows. It extends grants and direct loans to foreign governments to be used for government administered development projects (their disbursements are about 85 to 90 per cent of OECF funds); the OECF devotes the rest of its resources to making loans to, and equity investments in those Japanese enterprises (or groups of Japanese corperations) engaging in joint ventures with local interests in LDC's or in their feasibility experimental projects. The projects are chosen if they are deemed worthy of being considered as "economic cooperation through the private sector".

The OECF justifies its' loans to private Japanese companies, as geared at "taking advantage of the private sector's abilities to transfer funds, its' managerial know-how and the technical experience it offers to developing countries". Nonetheless, development projects are often accompanied by circumstances that may discourage the participation of private companies, such as lack of funds, inadequate infrastructure, and insufficient managerial and technical experience. OECF is authorised to grant loans to, and make equity investments in, Japanese corporations seeking financial support to enable participation in development projects. Thus, OECF specifically promotes overseas investment considered too risky to be financed without special financial subsidies, as a vehicle of economic cooperation. In these operations, public money is combined with private money to promote development of local private enterprises via joint ventures with Japanese enterprises that are seen to transfer both finance and industrial expertise; Ozawa op. cit. argues that "the financial as well as the industrial sector in Japan are simultaneously mobilised to help the recipient countries industrialise. The Japanese call this approach "minkatso" or "the utilisation of private vitality". Part of OECF funds (in the context of the new recycling initiations) will have an ODA component, disbursed under a scheme of "two-step loans" (see Figure 1), to local development banks or similar institutions, which in turn will lend to local enterprises.

Loans by the Export-Import Bank, like those by the OECF, are designed to use public money to prime the pump and get private funds flowing into development projects. The Export-Import Bank collaborates with Japanese private banks as the major joint lender in arranging syndicated loans to developing countries; the Bank provides 60 to 70 per cent of the required finance for a project, with commercial banks taking up the balance. The Bank's participation adds a major element of security for participating commercial banks, as the government has become a party to the loan and will assist in offering repayment, if necessary.

OECF involvement is reported (Spindler, 1984) to provide an even stronger signal than Export-Import Bank participation of Japanese government commitment to the success of a particular project. OECF equity participation in an overseas project usually results in its semi-official designation as a "national project". In this context, the Japanese government is ready to represent the interests of participating Japanese banks and corporations, if necessary, in bilateral discussions with the host government (which is likely to participate as a joint venture partner). In case of default or project bankruptcy, the Japanese government informally assumes an important level of responsibility on behalf of all involved Japanese parties.

Stallings (1988) describes how collaboration between public and private lending, through "national projects" is by no means a new mechanism, as it played an important role in Japanese lending to lend to Latin American projects in the 1970's. However, its' significance and more broadly, that of hybrid financing seems to be growing in the context of the new recycling initiatives. As we have seen these new initiatives depends heavily on cooperative financing organised by the OECF and the Export-Import Bank, which act as risk sharers or risk bearers for Japanese commercial banks.

c) Concluding Comments

We can conclude that the Japanese government approach to economic cooperation is rather special, in that it combines relatively small amounts of official development assistance with private and quasi-private flows; the approach is also special in that it sees financial flows only as one component of cooperation, with **transfer of technology, know-how and organisational skills** (mainly through direct investment or joint ventures) playing also a very important role. In this sense, Japanese analysts often stress that a financial Marshall type of cooperation is not enough to help developing countries as financial transfers need in this case be combined as much and as effectively as possible with transfers of skills, so the financial flows are best used.

The Japanese experience of "comprehensive economic cooperation" is not only very interesting in itself, due both to its' innovative approach to mixing public and private flows and due to the quantitative importance of these flows. An interesting issue posed when examining Japanese efforts is the following: Why only Japan has undertaken such major initiatives for recycling? Furthermore why is international pressures and interest (see for example Okita, Jawardona and Sengupta, op. cit. as well as others) only focussed on Japan doing more recycling to LDC's? Though Japanese surpluses are the largest - and the Japanese government the most flexible in increasing their use for recycling to LDC's - Japan is not the only country to have current account surpluses. Why is similar pressure not also applied to other industrial countries with large current account surpluses, and in particular to West Germany, to increase their recycling? Should not the international community (for example through the Bretton Woods institutions and other international organisations) suggest targets for a desirable pattern of current account results and corresponding international financial flows, which would include providing incentives and making efforts at channelling a larger proportion of both Japanese and German current account surpluses as flows to developing countries? Should not fast growing developing countries, with large current account surpluses, also not play some role in funding LDC's (or more broadly development finance, through institutions such as the World Bank) which are poorer and have current account deficits? (As regards the latter point it is encouraging that Taiwan is making a financial contribution to Costa Rica's debt reduction package).

As regards channelling West German surpluses two comments need to be made. Firstly, the international (and particularly US) pressure on Japan to recycle funds to LDC's may be somewhat stronger because its' trade surplus is to an important extent with the USA; thus, as discussed above, its' recycling is seen not only as directly beneficial to the LDC's, but indirectly to the US balance of payments. A second practical issue may be somewhat more relevant. In future, there may be a far stronger claim on West German surpluses, coming from Eastern Europe, and particularly the GDR (or if there is a unified Germany, there may indeed be a smaller surplus, initially). As a result, it may be in the near future more difficult to persuade the West German government to channel additional West German flows (particularly official ones which tend to be more limited), towards developing countries. In any case, the issue deserves further analysis from the international community and discussion with German government and private authorities.

Even though emphasis has been placed up to here on total flows from industrial countries with balance of payments surplus, it seems important to stress that as regards levels of ODA from individual industrial countries, these should be maintained independently of their balance of payments position.

Finally, as regards Japanese capital flows to developing countries (and in particular the hybrid and market elements), it is important to examine the extent to which their financial terms (as regards maturity, grace period, interest rate, etc) are appropriate to development funding, particularly but not only in the case of low-income countries. The extent to which part of ODA flows could be used to finance subsidies on private flows (as suggested by Okita. Jawardena and Sengupta, op. cit.) is an issue of particular relevance in the Japanese case, given the importance of private flows within total flows to developing countries.

IV. The future role of Multilateral Development Finance

In this final section, we will briefly discuss the new roles which multilateral development institutions should play in the future, with particular reference to the World Bank, and drawing especially on a set of studies prepared for the G-24 on the role of the World Bank in the 1990's.[8]

There is an emerging concern amongst different analysts (see, for example, several of the G-24 papers, but also Griffith-Jones and Rodriguez, 1989) that during the 1980's an excessive proportion of funding by multilateral development institutions, and particularly the World Bank, indirectly contributed to cover part of the highly indebted countries' foreign debt service, principally to private creditor banks. Resources have thus been diverted from funding of investment to contribute to debt service. Related to this is the fact that success in structural adjustment programmes has been excessively measured by their effects on debt servicing and economic liberalisation, as well as privatisation, and too little by the effects on the rate of capital formation, use of capacity, and on income distribution (Ffrench-Davies and Meller, 1989)

8 UNCTAD/UNDP studies on International Monetary and Financial Issues for Developing Countries Working Group of the G-24 on the role of the Bank in the 1990's. Project INT 1881021.

An important assumption behind World Bank designed structural adjustment programmes was that for new investment to take place and for it to be used more efficiently, the policy environment had to be improved. For this reason, structural adjustment and sector lending was to an important extent geared to policy reform rather than, as traditionally had occurred with World Bank lending, to fund investment. Towards the end of the 1980's, however, the opposite causal relation seems increasingly true. Policy reform and structural reform have increasingly become inefficient due to lack of accompanying investment. The assumption that policy reform on its own could stimulate production and investment is particularly doubtful in Africa, where supply bottlenecks (e.g. in transport) are especially dramatic (see Ndegwa, 1989).

Indeed, perhaps the most serious negative effect of structural adjustment lending is on investment levels. The most recent World Bank study on programme lending (World Bank, 1989) shows an apparently negative effect of structural adjustment on investment levels, which is particularly clear when comparing adjustment lending intensive countries with their comparators (in other variables, e.g. GDP growth, adjustment lending intensive countries do better than their comparators). Similarly, in a very comprehensive evaluation of the economic performance of countries receiving SAL and SECAL loans, Harrigan and Mosley (1989) conclude that their results "have indicated an alarming trend in terms of the effect of programme aid on investment. Both tabular comparisons with a control group and regression work provide strong evidence that Bank/SAL's and SECAL's have had an adverse impact on investment, and hence possibly on future growth".

Ffrench-Davies and Meller, op. cit. attribute the decline in investment in the 1980's in adjusting countries in Latin America to four factors: 1) Lower rate of use of capacity (caused by the need to adjust itself) discourages investment. 2) Inappropriate functioning of capital markets (due for example to incomplete markets, with weakened long-term segments due to financial crises, domestic reduction of support to national development banks due to fiscal crises and/or financial reforms and excessively high interest rates, due to financial reforms and negative net transfers of foreign exchange). 3) Privatisation may encourage private investment but implies a direct divestment for the public sector if the proceeds of sales are not diverted to increase public capital formation. If there is limited capacity to invest by the private sector, it is most probable that overall investment will tend to decrease. 4) Finally, and probably most important, the size of the external constraints made significantly worse by persistent negative transfers with creditors banks and more recently with multilateral institutions have been a major factor in explaining the low rate of capital formation.

A key role to which multilateral development banks need therefore to return to is to promote growth and more just income distribution.

So as to promote growth and investment, multilateral development banks would need to focus their policy advice on achieving those objectives (rather than debt service or liberalization, which seemed more dominant objectives in the 1980's).

To promote higher levels of investment, the multilaterals (and particularly the World Bank) need to contribute to accelerate and intensify the process of debt/debt services reduction, so as to free resources domestically for investment. A reasonable target put forward for example by Mistry (1988) is the progressive reduction of negative net transfers from highly indebted countries to achieve a zero balance within the next 2-3 years. As discussed in the introduction, this does not necessarily mean using an important part of its' lending resources for this purpose; on the contrary, the World Bank (and other multilaterals) need to explore ways in which as little as possible public flows can help trigger off as much as possible of debt/debt service reduction.

Other forms in which the World Bank can contribute to create a climate favourable for investment is via promotion of capital market development (particularly the more long-term segments), encouragement of domestic savings and development of savings institutions and promotion of equitable and efficient taxation measures, while ensuring that additional government revenues are channelled to productive and high priority investments.

Besides helping create a more favourable investment climate, the World Bank needs in the 1990's to shift back from balance of payments financing and revert to its' traditional role (and one in which it has in many aspects excelled) of project financier. As regards policy advice, the World Bank should, as Sachs (1988) concludes "give macroeconomic stabilisation priority over liberalisation". Though stabilisation is primarily a task for the national government, with support where necessary from the IMF, the World Bank may productively support stabilisation efforts by programmes on aspects such as tax reform and public sector rationalization (which not necessarily implies privatisation). Clearly some minimum of price stability is a pre-condition for increasing investment, and the World Bank (and multilateral development institutions) need to contribute to lowering unacceptably high levels of inflation in some developing countries, particularly in Latin America.

As regards the rest of World Bank policy advise which was so high profile in the 1980's (e.g. liberalization, privatisation), a useful distinction has been made by Lipton and Parlberg (1989). In countries where policy-based adjustment lending has been effective, the multilateral development institutions can declare victory and then move on to a new generation of "post-adjustment" investments (this is a particularly powerful argument as the more "extreme" aspects of liberalisation and privatisation tend to be most controversial as regards their development effectiveness, both in the academic literature and amongst LDC policy-makers).

In countries where adjustment lending has not been so successful in changing policies in the 1980's, Lipton and Paalberg, op. cit. suggest a different reason to re-emphasise project lending. As in these countries, lending needs - for growth and prosperity reduction - continue, the best alternative for World Bank would be to switch to leading to projects designed to be relatively "policy-proof", in areas such as infrastructural development, rather than continue a series of unsuccessful SAL's and SECAL's. If policy lending continues, it needs to be based on a better understanding of where and when rapid output responses are likely, which implies as much or more detailed techno-economic knowledge than economic theory expertise.

More generally, though some guidelines on broad areas of priority can be suggested (see below), renewed emphasis by the World Bank on investment and investment projects, implies that the key challenges for the World Bank (and other multilateral development institutions) are basically **technical, country-by country, sub-sector specific** and more often than in the eighties, sectoral or micro-economic. As such, they will tend to be more World Bank staff intensive (which may be problematic given recent efforts to reduce staffing levels); however, they will have an important advantage of being basically non-controversial, which will improve relations between the World Bank and LDC governments and enhance World Bank influence in the Third World. Indeed, Lipton and Paarlberg, op. cit. report that investment lending by the World Bank (for example hybrid loans, which join quick disbursing policy based lending with slow-maturing investments) is already helping to build a positive relationship between the World Bank and borrowing country government ministries.

Though broadly country specific, certain especially developmentally urgent needs have been identified as priority for World Bank funding. In the case of Africa, Ndegwa (1989) points to the urgent need for increased Bank funding of infrastructure; in Africa, the infrastructural situation is very bad, in comparison with other parts of the developing world (it is highly concentrated in certain countries and parts of these countries, existing infrastructure is disintegrating and maintenance is insufficient). This is particularly negative for two reasons: a) policy measures implemented under structural adjustment programmes may not yield desired supply responses due to transport constraints, both in delivery of inputs and freighting of outputs. Thus, if adjustment programmes are continued in Africa, they should include funds to deal with infrastructural constraints, that might inhibit supply responses. b) if African integration (via a production-sharing strategy that gives an important role to the private sector especially in agriculture and greater intra-African trade) is seen as a key element in future African growth and recovery, the improvements and expansion of infrastructure is also a major priority. Particularly important to encourage intra-African trade are railways and roads (especially railways and roads across African countries). The World Bank, according to Ndegwa, op. cit.. could not just play an important role in individual countries, but also coordinate investments in different countries to result in compatible networks.

At the level of agriculture and rural development, Lipton and Paarlberg outline general but clear priorities for World Bank lending, to address the three urgent areas of concern: employment, food production, and resource protection. As regards measures to help generate new rural employment, emphasis is placed on rural infrastructure (particularly for Africa and Latin America), electrification, appropriate education and training. As regards food production emphasis is placed on expansion of Bank lending to agricultural research and extension (areas with high productivity, which lagged badly during the budget crisis of the mid-1980's). Thirdly, high priority is placed on new investments in public goods, such as afforestation and drainage, as well as support for more egalitarian and efficient tax and tenure policies.

For Latin America, once the debt overhang is signifcantly reduced, a shift from structural adjustment lending to project lending would seem particularly appropriate. These could fund public investment in human capital, social needs such as low-income housing, in infrastructure and in research hurt during the debt crisis, and which produce benefits over the long run, even in spite of an inadequate macro-environment (though their beneficial effects will be far greater if there is a favourable macro-environment). In Latin America, projects in industry, with emphasis on innovative technology, will require important attention.

Finally, though we have emphasised a return to project lending, another appropriate modality for World Bank lending could be a return to the use of traditional programme lending (Avramovic, 1989). This would be applicable in cases where there are no obvious economic policy inadequacies, yet non-project funds are needed and can be justified developmentally; this would apply to relatively small investment projects and also to ensuring full employment of existing underused capacity.

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Ref: MK/SGJODF.doc 1.12.89