reassessing north-south economic relations

a tripartite report by thirteen experts from THE EUROPEAN COMMUNITY
JAPAN
and NORTH AMERICA
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THE EUROPEAN COMMUNITY
Theodor Dams
Institute for Development Policy,
University of Freiburg
Sidney Golt
Former deputy secretary, Department of
Trade and Industry, London
François Luchaire
University of Paris (Panthéon-Sorbonne)
Franco-Maria Malfatti
Former president, Commission of
the European Communities
Auguste Vanistendael
International foundation, Humanum

JAPAN
Yusuke Kashiwagi
Former vice-minister of finance for international affairs
Saburo Okita
Japan Economic Research Center
Akira Onishi
International Development Center of Japan
Tsunehiko Watanabe
Osaka University

and NORTH AMERICA
Edward R. Fried
Brookings Institution
A. F. W. Plumptre
Special adviser to the president,
International Development Research Center, Ottawa
Philip H. Trezise
Brookings Institution
Paul Wonnacott
University of Maryland

washington dc THE BROOKINGS INSTITUTION
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Reshaping the International Economic Order (1972)
Reassessing North-South Economic Relations (1972)
CRISES AND DISPUTES over international monetary and trade arrangements over the past few years have focused public attention on economic relations mainly among the advanced industrial countries. Yet North-South economic relations—those between industrial and developing countries—seem to have reached a dead end. North-South problems tend to be set apart as matters that have more to do with conscience than with practical economics and politics. Conscience is, of course, a large part of the problem, for there are massive and portentous inequalities in the distribution of the world's wealth and income. There are also, however, immediate and practical issues to be resolved. Relations between industrial and developing countries involve questions that will necessarily enter into the forthcoming negotiations on monetary reform and trade and into future negotiations on energy and the environment.

A group of private experts from the European Community, Japan, and North America met in Brussels, November 9–15, 1972, to examine the issues in North-South economic relations as problems integral to the reconstruction of the international economic system. This report summarizes the conclusions reached at the conference. Those who participated and signed the report did so as individuals, speaking only for themselves; their views should not be attributed to the organizations with which they are associated or to the foundations which helped to finance the venture.

The meeting was sponsored by the European Community Institute for University Studies (the host organization), the Japan Economic Research Center, and the Brookings Institution. Max Kohnstamm, president of the European Community Institute, served as chairman of the meeting. The conference was the second in a continuing series to be sponsored by these organizations to examine international economic policies from the three geographic perspectives.
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KERMIT GORDON
President
The Brookings Institution

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1. Introduction 1
2. Alternative Approaches 6
3. Trade Policy 10
4. Private Investment and Development 19
5. Export Credits and Portfolio Investment 23
6. Official Assistance 26
7. A Concluding Comment 31
"Earlier the problems of East-West tension were dominant: now we have a North-South problem of equal importance. . . . If twelve years ago the balance of the world turned on the recovery of Western Europe, now it turns on a right relationship of the industrial North of the globe to the developing South."¹

For more than a decade, the industrial countries—the North in Sir Oliver Frank's durable phrase—have been formally pledged to the assistance of the South. Specifically, "the economically more advanced nations should cooperate in assisting to the best of their ability the countries in process of economic development."²

In this report, we propose to assess developments since the member countries of the Organisation for Economic Co-operation and Development (OECD) thus committed themselves to help the developing countries and to consider what policies and actions by the industrial North are appropriate to the evolving relationship with the South. Is it possible to achieve a more dynamic international division of labor in which the developing nations participate actively in the world economy? This will depend in the first instance on an international monetary system that will ensure realistic exchange rates, a subject now under active negotiation.³


2. One of the three policy goals agreed to by OECD members at the Convention signed in Paris, December 14, 1960. OECD member nations are the United States, Canada, Japan, Australia, and all of the countries of Western Europe.

3. This subject was examined in Reshaping the International Monetary Order: A Tripartite Report by Twelve Economists from North America, the European Community, and Japan (Brookings Institution, 1972).
Reassessing North-South Economic Relations

The accomplishments of the past decade have been considerable. When measured against the problems of development, however, they leave much to be desired.

In the field of development assistance, all the industrialized countries have accepted, some with qualifications, United Nations targets for development assistance. Virtually all of these countries have by now established official agencies responsible for planning and providing development aid. Over the twelve years, 1960–71, net loans and grants financed by public funds ("official development assistance" in the term used by the OECD Development Assistance Committee) came to $72 billion. Finally, as evidenced by the "Green Revolution," a promising start has been made in the development of technologies specifically related to the economic and social conditions of the South.

In the field of international trade arrangements, the industrialized countries in 1965 undertook special obligations in the General Agreement on Tariffs and Trade (GATT) to assure greater access to their markets for low-income countries. More recently most of these industrialized countries have adopted tariff procedures intended to provide for enlarged imports of goods from developing countries.

Although progress has been uneven, a number of developing countries have had very substantial economic growth, with GNP expanding by nearly 10 percent a year, and sometimes by more. We have seen some low-income, agricultural societies become high-growth, industrializing economies in astonishingly short periods, and others may well follow suit. Trade in primary products, except for petroleum, has risen only moderately, but exports of manufactures seem to have crossed a threshold. The South, considered as a whole, has been increasing its sales of manufactured products to the point where they now account for 23 percent of total exports.

If we look at the averages, the developing countries as a group have in recent years shared at an accelerating rate in the remarkable economic expansion of the postwar era. During the first half of the 1960s the GNP of the developing countries taken together rose by an average of less than 5 percent per year. For the balance of the decade, the average was well over 6 percent.

The difficulty is that the averages obscure some stubborn facts. Many are by now familiar.

First of all, the capacities and the needs of developing countries differ widely. Some have neither resources nor "modern" experience in the arts
of production or administration; some have administrative skills and experience, but are vastly overpopulated in relation to their natural resources. Others seem to be much nearer to a situation in which they will need but little outside help, particularly if they can look forward to enlarging markets for products they can produce efficiently. Then, of course, there are those countries with reserves of petroleum or other primary materials which provide the basis for general economic expansion.

Second, most of the millions of people living in the developing countries are desperately poor. Their average standard of material well-being is less than one-tenth of the level in the industrial countries. Unemployment and underemployment exist in massive proportions and present an overriding problem for most of the governments concerned. Undernourishment and disease still impair the mentality and vitality of masses of human beings. And even improvements in production and availability of food tend to be counterbalanced by the additional millions of mouths—a population trend which has scarcely begun to yield to the various and varied approaches to better family planning.

Third, the difficulty of communication between the South and the North is a constraint on effective interaction that has become increasingly evident in recent years. It appears in relations with newly independent countries as well as with those longer established. In some international forums, dialogue has tended to deteriorate into unrelieved confrontation.

A fourth barrier relates to technology. The advances of modern technology are primarily suited to the needs of the industrialized countries. But the basic needs of the developing countries, such as improvements in diet, health, education, and family planning, must be attained in the context of cultures far removed from the jet aircraft and the computer.

A fifth constraint arises from shortcomings in administration, organization, and innovation. Where these familiar attributes of our societies are not indigenous, they are only acquired very slowly.

Finally, a debt burden has developed which, if it continues to accumulate, will become insupportable.

And insofar as the unique responsibilities of the North are concerned, most industrialized countries have not met their aid commitments, nor opened their markets in the spirit of their pledges in the GATT.

**Despite these obstacles, we remain convinced that economic progress in the developing countries is an objective that is both attainable and right. The ability to open our markets and to provide for an increased**
flow of resources to the poor countries is beyond reasonable question. If the Soviet Union and Eastern Europe could mount an effort comparable to that of the other industrial countries, the task would be easier still. It is also worth noting that official development assistance of about $7 billion per year represents only one-twenty-fifth of the military budgets of the industrialized countries. Surely an improvement in the international climate should in itself be an opportunity to spend less on armaments and more on assistance.

The broad political case for encouraging economic development in the South still rests basically, as it always has, on the belief that gross inequalities in the international distribution of wealth are morally unacceptable and incompatible with world peace and prosperity. The same motivation that leads the more advanced regions within a country to alleviate poverty in the less advanced may well be extended to the far deeper disparities that exist among different regions of the world. Development, as the Pearson Report emphasizes, is not a guarantee that the poorer nations will choose any particular ideology or value system. Nor can it assure in any part of the world, either stability or responsible behavior. But it may well be indispensable to providing leeway for and giving constructive direction to social change.

Beyond these general considerations, there are compelling specific reasons at this time for a positive Northern policy towards the South. The industrialized countries have recently begun the process of reordering their own economic relationships, in the aftermath of the 1971 crisis of the Bretton Woods system. Monetary reform negotiations have begun. A new round of trade talks is scheduled to begin in 1973. Direct investment and the multinational corporation are potential items for the international agenda, and so may be the question of energy supplies.

These matters cannot be debated and resolved without the participation of the developing countries. Monetary reform, which is arguably the centerpiece of the enterprise, will in practice require the concurrence and the cooperation of nonindustrial members of the International Monetary Fund. In other things as well, the views and interests of the South will impinge on the concerns of the industrial world, and accommodations will have to be made.

Thus, the management of the natural environment and the conservation of the world’s resources will require more and more communication and

cooperation between North and South. We do not accept the apocalyptic arguments which call for an end to economic expansion because of the alleged impending exhaustion of the earth's physical endowments. We believe, on the contrary, that only through well-directed economic growth can many of the world's problems be controlled successfully. But we do not set aside the warnings of potentially grave damage to the environment to be seen in the destruction of animal species, in the deterioration of the quality of the air, in polluted waterways and even seas.

It is clear that these ecological threats cannot all be dealt with by one country or any selected group of countries; collaboration on a global scale is also necessary. As was learned at the 1972 United Nations Conference on the Human Environment in Stockholm, however, the North and South have somewhat differing perceptions of their interests; to many people in the South poverty is the primary pollution to be eliminated. These differences will have to be reconciled not simply through discussion and negotiation, but by building habits of collaboration into the economic relations between the widely differing countries of the world.

All of this is only to restate the reality that the developing nations are part of an increasingly interdependent world system. We in the advanced countries can better provide for our own prosperity and for the preservation of the global environment only by collaboration and cooperation with the developing world.

Thus a "right relationship" between the industrial North and the developing South is as relevant and even more necessary than it seemed to Sir Oliver Franks thirteen years ago. Even if we were to ignore the great moral questions raised by extremes of wealth and poverty in the world—which we cannot—there would be pressing economic, political, and practical reasons why development in the South should be an objective of the governments and peoples of the more fortunate countries. The central question is not whether or why, but rather how: how can the development objective be pursued effectively in the changed circumstances of the 1970s?
STEADY GROWTH and high employment in the industrial countries are essential conditions for, although they are not in themselves a guarantee of, economic progress in the nonindustrial nations. In our highly interdependent world, a well-functioning international monetary system is important for all countries, not just the principal financial powers. If the United States, Canada, Japan, and the European Community are to try to resolve the trade problems that exist among them, the result will be critically important for the developing countries. So, although we focus our attention on three subjects—trade, private investment, and official development assistance—we are conscious of the interrelationship of these matters with other policies, especially with domestic employment policies and with the international monetary arrangements.

We need first to consider the general approaches of the North to their relations with the South. We have two interrelated issues in mind. One relates to "zones of influence," the other relates to independence and membership in the family of nations.

Zones of Influence

Most developing countries in the South have special ties, of one sort or another, with particular countries or groups of countries in the North. In many cases the relationship stems from a colonial one, sometimes extending up to a relatively few years ago. In other cases it stems from a politico-military situation such as that epitomized in the Monroe Doctrine. In a further instance, that of Japan, the relationship that has been emerging with Asian countries is based on the economic dynamism exhibited by that country in the postwar period.
The question that now arises is whether that type of relationship should, as far as development policy is concerned, be continued and crystallized into accepted "zones of influence."

It is our view that such a regionalization of world development policies would be a grave mistake. Of course, traditional ties of many kinds will continue and geography will not change. Nevertheless, we believe that the thrust of the future should be in the direction of common rather than competitive development policies amongst the industrialized countries of the North.

A future world divided formally into "zones of influence" is not out of the question. The European Community has established preferential arrangements with a sizable number of African and Mediterranean states. Under the terms of British entry, these arrangements may be extended into a preferential system covering most of Africa and the Mediterranean area. Japan's natural economic ties with Asia might provide a basis for a regional system there. And the concept of a United States–Latin American preferential trading area will always have its political attractions for some.

Quite apart from the economic consequences of regionalization, all political experience argues that economic blocs are likely to acquire a neocolonial stigma. Instances are all too available—the United States and Latin America, Britain and parts of the sterling area, France and post-independent Algeria may be mentioned—which suggest that close and extensive economic ties do not assure smooth bilateral relations. Expectations that special economic arrangements will provide preferred access to markets and raw materials or give security to investments are likely to be disappointed. It is the global competitive market rather than the preferential regional market that appears to have the stronger potentiality and ultimately the stronger attraction.

We are convinced of the advantages of concerted efforts among the industrial countries in their development policies. A basic requirement is improved market access for the manufactured goods of the developing countries. In practice, this can be achieved in satisfactory measure only if the rich countries act together to open their markets and to circumscribe the use of safeguards against market disruption. In the same way, the depoliticizing of development assistance can best be achieved through increasing reliance on multilateral coordination and provision of aid. The debt problems of the developing countries obviously call for agreements among all creditors on how to manage their separate and joint interests; and an agreed doctrine and practice on export credits is urgently needed if
more acute debt situations are to be avoided. We think that the best prospect for reducing the political objections to private investment probably lies in multilaterally agreed and monitored policies.

Equality of Rights and Responsibilities

In the second place we have the related issue of the independence, sovereignty, or self-determination of the developing countries. The North-South relationship will be most satisfactory, least open to misunderstandings and misrepresentation, if the developing countries act as full members of the family of nations—the weight of their views enhanced by the obligations they are ready to assume.

To this principle we would add a point of elaboration. Just as the law and practice of most countries recognize the need to ensure that bargains are not unbalanced and that the strong do not oppress or exploit the weak, so in the international community is it necessary for the industrialized countries to recognize and try to avoid the misunderstandings likely to arise in dealing with countries whose cultural backgrounds and administrative experience differ widely.

If, subject to this elaboration, country-to-country dealings are on the basis of equality, this implies that trade, the private capital markets, and direct investment should have expanding roles in the development process, and developing countries should have access to commodity and capital markets in any part of the world, and not be restricted to any particular zone. It also implies that official assistance, which will be a necessary and substantial supplement for some countries for longer or shorter periods, ought increasingly to be directed through the international institutions to points of need, for requirements that could not otherwise be met, and on nonpolitical bases.

A North-South development relationship based on equality implies shared responsibilities and obligations. Thus we believe the poorer countries should allow investment disputes to be placed before international bodies for adjudication, assuming those bodies include representatives from South and North alike. We think that applicable GATT rules ought to be accepted by all contracting parties. We consider that the poor as well as the rich countries should submit their exchange rate policies to greater international surveillance in the future. The evolving international economic order surely is going to require further limitations on “sovereign rights” and the developing countries should expect to take their place in this process.
At the same time, we believe the developing countries must have equal opportunity to advance their interests in the evolution of the international order. This principle should apply to negotiations on trade, on monetary arrangements, on environmental safeguards—indeed, wherever the steady trend toward interdependence will require the reworking of economic arrangements.

**Internal Considerations**

There is finally to be considered how questions of social justice should affect the North-South relationship. In many of the poor countries today, we see extreme disparities of income, inhuman conditions of life, or unrepresentative governments. In reaction to these conditions, a body of opinion has grown up which believes that the priority given to economic growth itself may be wrong. The argument is advanced that a radically more equal distribution of income, accompanied by priority measures to maximize employment, provide the proper model for many of the developing countries.

We believe that these matters in the main must be left to those directly concerned. It would be unfair to assume that peoples have disavowed an interest in achieving greater material well-being before they have been given the chance to exercise a choice. We do not think that the issue of social justice can be determined from the outside. Economic growth will, of course, make little sense if its benefits are not spread generally. But while we may be able to concentrate development aid on labor-intensive projects and otherwise to integrate social with economic aims, our development policies cannot be decisive in achieving social goals for others. These judgments must be made by the developing countries themselves, and the outcome will depend principally on their actions. This is consistent with our general proposition that the North-South relationship must be increasingly between independent partners.

We are persuaded, in summary, that the “right” North-South relationship, properly understood, is an integral part of the “right” relationship that must be built among all countries in the world. The direction of Northern policy toward economic development should be founded on economic principles and directed toward multilateral action. It must de-emphasize tutelage and emphasize shared responsibilities and obligations. These propositions will be expressed in more concrete terms in the pages to follow.
TRADE POLICY may well be the primary test of North-South relations, just as it will be for relations among industrialized countries. The objective in both cases is the same: can we achieve a more productive and dynamic worldwide division of labor? This is not a question of rich countries giving assistance to poor countries, but of assuring greater mutual gains. As far as the North-South relationship is concerned, it is a question of providing the developing countries with the widest opportunities to realize benefits from their export potential.

The world stands now at the outset of major negotiation on the shape of monetary and trade relations. The possible content and the desirable outcome of these forthcoming negotiations were discussed in detail in a report in which some of us collaborated, and the general conclusions of which we endorse. Briefly, these are as follows:

1. The first essential is to get the basic international monetary structure right. In our view, if this is achieved a large first step will have been taken toward removing some of the more evident causes of disequilibrium. It will then be possible to move forward again in the civilizing of trade relations, the momentum of which is currently interrupted.

2. There should be a renewed attack by the advanced industrial countries on remaining barriers to international trade; in particular, their tariffs and quotas on manufactured goods and raw materials should be eliminated in stages over a ten-year period. There should also be a systematic reduction of agricultural protection; agreement on rules governing other non-tariff restrictions; and an agreed regime to limit any relief required for particular industries. Existing preferential arrangements would then become transitional.

It is within a framework of this kind that we see the greatest hope for expanding the trade of the developing countries. Export expansion was a major stimulus to the remarkable growth of output in the world during the 1960s. It can play an even more substantial role during the 1970s as a contribution to continuing growth of the developing countries.

This is not to embrace the rhetoric of "trade not aid"—a slogan which, like so many others which have become fashionable in the development field, obscures rather than clarifies the issue. The relationship between trade and aid as engines of progress is complex, but certainly they should be complementary. For some of the countries which have been successful as exporters, the industrial and commercial infrastructure which aid has helped to provide has been a necessary ingredient. We think it inevitable that exports must continue to finance the bulk of imports required for development, quite apart from the influence of active export industries in promoting productive internal change.

**Trade in Manufactures**

It is, however, necessary to qualify the usual picture of what is involved in this situation. Taken as a whole, the developing countries have been increasing their industrial exports at about 15 percent a year in money terms for almost ten years, and are progressively adopting the policies on exchange and interest rates which are needed for success in export policy. Countries such as Brazil, Iran, and Mexico have joined the earlier exponents of export-led growth—Korea, Taiwan, Hong Kong, and Singapore. A growing number of primary product exporters—for example, Malaysia, Thailand, Colombia, El Salvador, the Ivory Coast, and Ghana—are increasing their exports of manufactured products at a rapid rate, although the total amount of these exports is still small.

Certainly, much of the export activity of the developing countries will continue to be in traditional products. But an increasing number of them are building up an efficient basis for substantial new exports.

Continued rapid growth will make a number of developing countries major participants in world trade by the end of the decade. For some others, the prospects for early development of manufactured exports are less bright. Where the developing countries make substantial progress in export markets, a significant contribution will be made to their growth; and the industrialized countries will likewise gain from the increased efficiency of world production and the higher overall level of welfare.

We therefore welcome the statements which have already been made at
the November 1972 session of the contracting parties to the GATT which foreshadow negotiations on this pattern. We look forward to the creation of conditions in which there will be continuing growth of exports of manufactures from an increasing number of developing countries.

If, however, possibilities of this kind are to be realized, the developing countries must be brought fully into the negotiations from the beginning, and their interests and problems must be seen as an integral part of the whole. No doubt the main dynamic in the trade negotiations will be the desire of the United States, the European Community, and Japan to overcome the problems arising among them. But there is much to be put right in the relations between the developing and developed countries and in the operation of policies which have borne adversely on the former.

All industrial countries have applied quantitative restrictions on a wide range of manufactured products, sometimes with meager justification. Textile quotas, sanctified by international agreement under the GATT, are only the best known example. The United States uses, or has used, the technique of voluntary export restraint agreements to restrict imports of such commodities as wood screws, thermometer blanks, umbrella frames, and stainless steel flatware, as well as a major item like steel. Western European countries continue to have a large number of import quotas in contravention of the GATT, and applied in a discriminatory way against Japan and the low-wage countries. Japan until recently maintained many import quotas, even in the face of a balance-of-payments surplus that assumed embarrassing proportions. We see the GATT negotiations as an opportunity to make a determined effort to deal with these impediments.

Again, the negotiations will no doubt be based on the principle of reciprocity of bargaining between the major countries—and in the last resort this means striking a bargain among the United States, the European Community, Japan, and Canada. We do not believe that the industrialized countries should expect any sizable reciprocal contribution, in conventional trade negotiation terms, such as substantial reduction in tariff protection of domestic industry, from all developing countries. On the other hand, for those developing countries who are playing a significant part in international trade, and hope to become full partners in it, it will be in their own long-term interests to accept progressively the same international discipline—in regard to such matters as, say, export subsidies, nontariff barriers and other distortions of trade, avoidance of discrimination and the gradual elimination of excessive protection—as their industrial-country partners.
The ultimate objective is a sharing of rights and obligations; the sooner that there is a concerted move toward this the better.

We believe that progress of this kind would create new productive centers in the world, with widespread benefits for all. But this is not to say that these benefits do not bring in their train adjustment problems for existing industries in the older industrialized countries.

Still, it would be wrong to exaggerate the adjustment difficulties in the industrialized countries associated with an increase in exports from developing countries. We are certainly nowhere near a general deluge of goods from these countries. To put the magnitudes into perspective: if manufactured exports from developing to industrial countries expanded by 15 percent per year, they would still reach only $28 billion by 1980—or approximately 7 percent of the total imports of manufactures in the more affluent countries. Adjustment to the growth of imports from the developing countries will represent only a small change compared to the adjustments continuously taking place in the face of changes in technology and everyday shifts in demand.

For particular industries, and for particular localities, the economic impact and social consequences could, of course, be considerably greater than the aggregate data suggest. Cases involving substantial job losses in uncompetitive industries may call for remedial government actions, of which the most important are measures to promote economic expansion and full employment. In most industrial countries, the potential job displacement effects of imports might well be swamped by the job requirements of full employment. But it will not be possible to escape the need to include in the negotiations some provision for specific safeguards against market disruption; to do so would be to fly in the face of realities.

Nor need this be deplored. With lowered barriers to trade and greatly increased international commodity flows, occasions will arise when a sudden heavy increase in imports will prove too much for the normal processes of economic adjustment to absorb. In these circumstances some kind of safeguards to restrict imports will be politically and socially necessary. Dangers arise from the fact that safeguards mean different things to different people. To some, they are a means to facilitate trade liberalization in the sense described above. To some they are exactly the opposite: a means of restricting trade wherever the competition becomes significant. To others they are a device to postpone painful adjustment decisions regardless of the cost to third countries.
In examining this question, the OECD Group on Trade and Related Problems emphasized that when safeguards are permitted they must be limited in time, decrease in incidence, and be internationally agreed and monitored. The OECD group placed the responsibility where it belongs—on the obligations to be undertaken by the country applying safeguard restrictions. It specified these obligations as follows:

a) In the first place, the temporary nature of the protection measures should be emphasized by setting a relatively short time limit on their application.

b) Second, the applicant country should undertake in any case not to reduce its imports below their level at the time the restrictive measures are applied and to allow imports to increase at a reasonable rate.

c) Finally—and this is a fundamental point—application of the safeguard measures should be accompanied by action to bring about domestic adjustment so that use of the safeguard mechanism will in fact be temporary.6

Adjustment to trade liberalization need not create a great burden. The safeguard and adjustment provisions in the Rome Treaty have barely been used. Nor have the safeguard provisions of the European Free Trade Area (EFTA) Convention. No significant difficulties seem to have been experienced in accommodating to the full removal of tariffs despite a manifold increase in trade in both cases.

Japan's future growth, indeed, is partly predicated on its plans for structural adjustment. If, as projected by the Japan Economic Research Center, the growth of Japanese real GNP averages 9.5 percent during the decade, the average wage of Japanese workers will reach 80 percent of the expected U.S. wage in 1980. In preparation for this, the Japanese government is encouraging a shift in production away from labor-intensive products with the deliberate intention of replacing them by imported manufactures. The share of manufactures in imports is projected to rise from 30 percent in 1971 to at least 50 percent in 1980. This will amount to $40 billion, of which no doubt a sizable proportion will come from developing countries.

We have tried in the foregoing to sketch the ways in which the developing countries might share in the benefits to be gained from the forthcoming international negotiations, and the actions the industrial countries should take to this end. Meanwhile, many industrial countries (but not yet the United States or Canada) have introduced the so-called generalized

preference schemes and much has been hoped for from these schemes as the answer to problems of the developing countries on exports.

The objectives of the original proposals on special treatment for developing countries were not, in fact, "preference" in the form in which it has emerged. It was rather access to the industrial countries' markets, unimpeded by tariffs or quotas and without any reciprocal concessions by the beneficiary countries. It was an attempt to apply for the developing countries, faster and more completely than the advanced countries were ready to do for their supposedly more competitive industrial trading partners, the possibility of duty-free entry, without quota restriction. This was (and remains) the logical outcome and ultimate vision of the process of trade and tariff negotiation of which the Kennedy Round, at that time, was the concrete manifestation.

In the event, the generalized preference schemes are a pale shadow of these objectives. By all means, efforts should be made to improve such schemes—to get rid of exceptions, to extend application to other products including, especially, processed raw materials and processed agricultural products, and to eliminate restrictive aspects. Because of these limitations, existing preference schemes now stand in some danger of worsening rather than improving the real opportunities available in the industrial countries' markets.

In our view, it would be misleading to regard these schemes as a substitute for ensuring the full participation of the developing countries in a successful major trade negotiation. We believe that the best prospect for the developing countries is real and irreversible progress in the improvement of their opportunities in all markets by movement towards elimination of tariffs and real, not sham, removal of quantitative restrictions. They will be the more secure in the achievement of these benefits if all the major trading countries act jointly in this regard, and action for each of them is then made easier by the knowledge that others are also expanding their markets.

**Primary Products and Agriculture**

Primary materials and agricultural goods still account for the majority of the exports of the less advanced regions. Nevertheless, allowing for certain exceptions, the outlook for these products does not indicate rapid expansion of exports on anything like the scale possible for manufactured goods.
Reassessing North-South Economic Relations

For the countries with sizable reserves of petroleum and certain minerals, of course, export prospects are strong. Demand is rising sharply, the volume of trade is immense, and the major producing countries are able, within limits, to exert upward pressure on prices.

Most other primary products will have expanding markets, as the world economy grows, but none of them are remotely to be compared to petroleum as potential export earners. The primary materials present questions about ownership and control and about the proper location of processing facilities. Each instance is likely to be special, however, and we do not see the basis for policies of general application, beyond the benefits that would accrue from the removal of tariffs and other barriers to trade.

Agriculture is overwhelmingly the principal activity of the developing countries. Improvements in the conditions of agricultural production and increases in farm income will remain priority problems in the poorer countries for the foreseeable future. They will also have to meet an increasing demand for food in rural and urban areas while relying less on international food aid. These requirements suggest that agricultural products—with a few exceptions—do not offer major prospects for export growth to developed countries.

It is worth noting market prospects in each of the major agricultural export categories.

Tropical Exports

Market opportunities for tropical products have in some ways improved in recent years as trade barriers have been removed. Further improvements might be achieved if special excise tax burdens were reduced and if the Soviet Union and East European countries were to change their buying and internal price policies for these products. But, in general, demand is rather inelastic, and the room for expansion limited.

There are agricultural materials, like jute, hard fibers, rubber, and many others, where much more of the processing could be efficiently undertaken in the developing countries of their origin. The inclusion of processed products in the arrangements we have discussed above for manufactured goods would significantly improve the developing countries' prospects. General tariff reductions would similarly help exports of processed foodstuffs. This is one of the areas of trade where industrial countries have been most resistant to liberalization. It has manifested itself even in the restrictions within the generalized preference schemes.
There have been many efforts—including the most recent for cocoa—to create international commodity agreements for tropical agricultural products, as well as for raw materials. So far, there exist for tin and for coffee more or less worldwide agreements, which have been successful in preventing sharp declines in prices. There are a variety of other more limited arrangements, some of them affecting only part of the producing countries, others built around special price or supply arrangements for the benefit of particular suppliers.

There may be other cases in which the international community can organize markets so as to prevent wide price fluctuations and provide benefits for producers in developing countries. These would be all to the good. We are doubtful, however, that commodity agreements can be effective in substantially increasing export earnings for primary goods on a world scale.

**Temperate-zone Products**

There remain those agricultural products from developing countries which compete with temperate-zone production in industrial countries. We believe that in their own interests, the industrial countries need to begin to dismantle the formidable structure of obstacles to trade in those products, and that reductions in agricultural protection are an essential element in the forthcoming GATT negotiations. There will no doubt be benefits to the developing countries from this process, and there may be particularly encouraging prospects for some commodities, such as animal feed grains, beef, fish, and perhaps fruit.

It remains true that, in the general run of products of this kind, developing countries are on the whole less efficient producers than most industrial exporting countries, and that in many cases they cannot meet their own needs from domestic production. We do not, therefore, see the likelihood of substantial export gains in these areas. Nevertheless, the policy prescription for industrial countries is clear: to provide technical assistance, wherever feasible, to improve efficiency, and to provide access to their markets where exportable surpluses arise in developing countries.

**The Special Case of Sugar**

Sugar is a special case of a product that is produced in both the tropical and the temperate zones. Sugar ranks third among internationally traded agricultural goods, and is of particular importance to the export trade of
some of the poorest countries, including some that can export little else. Trade in sugar is now subject to a number of special arrangements: the International Sugar Agreement (relevant mainly to the small free market); the Commonwealth Sugar Agreement between the United Kingdom and its associates; the U.S. sugar legislation (which holds part of the American market open to imports, normally at premium prices); and the European Community's internal system of guaranteed price which has made the Community of Six a sugar exporter on a substantial scale.

The American sugar law, the Commonwealth Agreement, and the International Sugar Agreement all are up for renewal or revision in 1974. Commonwealth arrangements in any case must be fitted into the Community's agricultural policy. The occasion arises therefore to agree on changes in domestic price and production policies in the industrial countries, so as to open markets for lower cost and low-income suppliers.

We believe therefore that for both manufactures and primary products the interests of the developing, as of the industrial countries, will best be served by determined resolution to bring about the success of the trade negotiations on the lines that have been suggested. Increasing freedom of the international market in manufactures over the past twenty years has been the engine of vastly increased prosperity for the industrial countries. In the last ten years, an increasing number of developing countries have demonstrated that even with existing limitations, they can benefit substantially from access to that market. On all counts, including their own self-interest, the duty of the industrial countries now is to refrain from actively distorting the freedom of the market against the developing countries.

It would be reasonable, and will no doubt be necessary, to find ways of moderating the effects of change, especially of rapid change concentrated in particular narrow sectors. But the advanced countries should make all possible effort to refrain from restrictionist interventions and to remove current distortion. As far as agriculture is concerned, the attainable prizes for the developing countries are perhaps smaller, but the goal is the same. Over the whole field, it will be of the utmost importance to ensure that the problems of the South are fully considered in the process of negotiation, and that the countries of the South participate effectively in that process.
Flows of private direct investment to the developing countries have been rising steadily and in 1971 were more than $4 billion. These flows of course are separate and distinct from official development assistance. Their volume and character are determined essentially by the decisions of private firms.

Of the total stock of private direct investment in developing countries, which comes to about $40 billion, one-third is in manufacturing industry, about equal to investment in petroleum. In spite of its expansion and diversification, however, private direct investment has come under criticism in some developing countries and on the part of observers elsewhere as having only a limited or even a negative impact on economic development.

The critique of private investment (and the multinational corporation) includes the following:

- Private investment may be costly in balance-of-payments terms.
- It may lead to the creation of foreign enclaves which discourage the growth of local entrepreneurship.
- It may be anticompetitive, either because it is based on overwhelmingly superior market organization or because the multinational corporation is powerful enough to assign market shares to its subsidiaries; it may thus inhibit rather than stimulate the growth of exports of manufactures.
- When host governments offer investment incentives in the form of subsidies or import protection—in some cases at the demand of the foreign firms—it may bring about and perpetuate uneconomic production.
- In the bargaining between a large multinational corporation and the government of a developing country, the former may have overriding advantages in its access to legal and other skills and in its sheer market power.
Reassessing North-South Economic Relations

- It may absorb local savings which might otherwise go to local investment.
- It may interfere with or distort host government development planning by causing changes in the allocation of resources.

We recognize that the misgivings about the role of private direct investment are a factor in the North-South relationship. The affirmative case, however, also must be considered.

In the first place, the transfer of resources, skills, and knowledge through the vehicle of private investment is a standard tested procedure, which comes naturally out of the manner in which the advanced market economies are organized. As a practical matter, the private corporation in these economies is a unique possessor of certain skills, especially of an organizational and managerial kind, and of technological processes as well. In some cases, these can be provided only through direct investment. The alternative possibility—licensing of technology or contracting for managerial help—may not be feasible for countries in an early stage of industrial growth. Hence the package of capital, management, and technology that a multinational firm can provide may not be available in any other form.

Second, private investment is likely to allocate resources efficiently. (It is nevertheless true that distortions may be introduced, either by host governments which are willing to subsidize investment in various ways or by private firms with market power.)

And third, foreign direct investment will be essential to enable the developing countries to take optimum advantage of greater access to export markets. In the countries where manufacturing export industries already have had strong growth, foreign private investment has been an important factor, and it can play a similar role in the development of other countries.

Whatever the weight of the different arguments, one thing seems to be clear: it is not for the industrial nations to decide whether developing nations should avail themselves of the opportunities offered by foreign direct investment. This decision is and must remain theirs.

Undoubtedly there will be problems, as when a country seeks assistance from an international institution to finance an investment which could be made, in other circumstances, by a foreign private firm. The argument will then be raised that the use of concessional funds for this purpose is unwarranted since these funds would then not be available for purposes that could not otherwise be financed. We have no general solution for such problems, and we doubt that there is one. Each instance is bound to differ from the last and will have to be decided on its merits.
In recognizing the right of each country to decide its own policy toward foreign investment, we believe that an obligation exists to assure fair treatment of investments already in place and to accept impartial mediation of disputes through, for example, the International Center for Settlement of Investment Disputes.

So far as the advanced countries are concerned, official policy has a rather limited direct role in determining the volume of private investment abroad. A few countries offer tax or other incentives for investment in developing countries and the United States has exempted these countries from the application of its balance-of-payments restraints on foreign direct investment. In the main, however, the principal means of encouraging investment flows has been to offer governmental insurance against political and exchange risks.

The official insurance schemes evidently do contribute to increasing the flows of investment. In major investing countries—the United States, Germany, and Japan—the insurance facilities are used for a substantial portion of total investment in the developing countries and many investment decisions no doubt rest on the ability of firms to insure against the special risk believed to exist in certain developing nations.

On the other hand, investment insurance may bring governments into the investment process in a greater measure than intended. Official risk-bearing implies some official voice in deciding which investments will be safe, and in what degree, and therefore which should be made. Moreover, if insured investments are nationalized, the insuring government is likely to become more involved than would normally be the case, possibly leading to political confrontations.

We consider that the proposed World Bank multilateral insurance plan (the International Investment Insurance Agency) would be a desirable addition and alternative to the national schemes. While offering the same incentive to investors as the bilateral insurance plans, it would be at greater remove from national concerns; its participation in the process would give the developing countries a neutral source of advice. And even if the developing countries did not participate in its financing—as now seems probable—it would still represent the World Bank community and would help to diffuse and reduce emotional and political factors.

We note with great interest the considerable innovation in the forms which private foreign investment has taken in recent years—all designed to provide for increased local participation in ownership and management. The Development Assistance Committee of the OECD mentions, for example, joint ventures with local, private, or public interests; participation
by regional investment companies and the International Finance Corpora-
tion (IFC); consortia in which no single investing country has a controlling
interest; minority investments coupled with management contracts; and
production-sharing agreements. The private business sectors of our coun-
tries seem to be quite flexible in adapting to attitudes in the developing
countries.

New modes of overseas private investment are being discussed in Japan.
They include technology transfer separate from equity and management
participation, gradual transfer of ownership to local entrepreneurs (divest-
ment), production-sharing arrangements to recover investment in the form
of products, and transfer of know-how of medium- and small-scale indus-
tries by providing government funds to private enterprises.

These nontraditional methods of investment must be tailored to indi-
vidual situations. We believe that the IFC may be able to have an increas-
ing role in the adaptation of private investment to the changing political
climate. Also, we have especially in mind that the IFC can take a minority
equity position in particular instances. This equity can later be sold to
local investors, as the enterprise becomes established and as local funds
become available. The direct participation of the IFC is helpful, more-
over, in assuring that direct investments do not include features unfair to
the host countries. An extensive role for the IFC in equity participation in
direct investment, however, will require an increase in its paid-in capital.

Finally, we have considered whether a code, or codes, of conduct for
private investors and for host governments would be feasible or useful.
Foreign direct investment has been the subject of a considerable amount
of study in our several countries, but we do not feel able to make specific
recommendations regarding codes of conduct without more exploration
than was possible on this occasion.
RESORT of the developing countries to industrial private capital markets has become increasingly important over the past few years. This activity includes the use of export credits and the flotation of portfolio investment.

Export Credit

The subject of export credit flows to the developing countries is both controversial and complicated.

In the first place the amount of export or supplier credit is large. The net flow to developing countries rose from an average of $668 million in 1960–65 to $2.7 billion in 1971. The 1971 figure was almost identical with that for the sum of official bilateral loans to the developing nations.

Second, export credits apply to virtually the entire range of commercial transactions between the industrial and the less developed countries. Also, it is now normal procedure almost everywhere for governments to guarantee export transactions of all sorts, ranging from sales of heavy equipment to sales of consumer goods. The ready availability of these government guarantees unquestionably has helped to swell the volume of export transactions.

Third, it appears that the increase in export credits—or borrowing to finance imports—has been in most countries a factor contributing to economic expansion. The assumption must be that the goods so financed in the main are being used effectively to sustain and foster economic activity.

Where the export credit phenomenon becomes troubling is in the context of the debt-service problem of the developing countries. Out-payments on foreign debt threaten to increase at an average of 15 percent or more during the 1970s and to be an extremely heavy burden for some countries. The Development Assistance Committee has warned that debt
Reassessing North-South Economic Relations

will continue to be a priority problem in the course of this decade. Three-quarters of all present debt service is traceable to export credits.

To the extent that debt service cannot be managed out of foreign exchange reserves and earnings, it must be financed by other loans or grants, renegotiated, or defaulted. When the form of financing is official development assistance used indirectly to pay for debts incurred through the export credit mechanism, an obvious question of fairness arises. A very divisive issue appears when some advanced countries find themselves through their official assistance indirectly paying for other advanced countries' exports. Furthermore, to allocate development assistance financing to countries having the most severe debt problems is not necessarily the most useful distribution of scarce resources.

It is difficult, therefore, to avoid the judgment that if the international community insists on financing exports to the developing world on an excessive scale, the result will be to convert some of the export credits, through the process of debt rescheduling, into long-term lending. Thus, export credits may become in part another form of official development assistance. And, while the export credits originate in a competitive scramble for exports, debt rescheduling needs to be planned collectively, so that all lending countries are assigned fair shares of the costs of revising the terms of debts.

Debt rescheduling, however necessary it may be, is likely to be costly to the developing countries, since in many cases they will find that their credit worthiness and ability to borrow will have been damaged.

We find no simple answer to these problems, however. Export credits do contribute to the economic development of the poor countries as well as to day-to-day economic activity. But they may also, as we have seen, make more difficult the debt-servicing problem. In some cases, moreover, easily available export credits have led to unwise and wasteful imports by developing countries.

What is warranted, we believe, is that the international community should monitor its practices and policies in the export credit field much more strictly than has been the case up until now. The best way to do this, we think, would be for the International Monetary Fund to take responsibility for reviewing flows of export credits to particular countries, evaluating them in relation to domestic economic growth and against the background of the volume of debt being assumed. This would be a kind of early warning system through which borrowers and lenders alike could be advised of potential problems ahead. The IMF could discuss its findings
confidentially with both lending and borrowing countries in the course of its regular annual consultations. In especially threatening situations, the Fund could recommend more rigorous controls over export credits or even the imposition of temporary ceilings.

**Portfolio Investment**

A growing number of developing countries have been turning to the private capital markets in the industrial countries, and for increasing amounts of funds. The volume of borrowing, through bond issues and bank credits of seven to ten years in duration, may have been as large as $3 billion in 1971, again about the same amount as official bilateral lending.

The borrowings differ from guaranteed export credits in an important way. The developing country—or rather its government—is normally the borrower and thus the guarantor of the loans. The commercial market, rather than the government in the lending country, judges the credit worthiness of the borrower, decides on the risk to be taken, and stands to lose if its judgment is wrong.

We see in this growing recourse to the private capital market a highly desirable trend. It represents a return to a traditional method of financing economic expansion. It leaves the borrowing country free to make its own decisions and it places on the private market the responsibility for evaluating the merits of each bond issue or loan. As more developing countries acquire the capacity to borrow on private markets, official development assistance could correspondingly be concentrated in areas of greatest need.

In our opinion the World Bank might provide technical advice on request to developing countries wishing to make placements on the private markets. The Bank's long experience with the world capital markets makes it a repository of knowledge and skill which could be made available to the developing countries.

Borrowing on the private market could, of course, be overdone, and the management of debt burdens made more difficult thereby. The need to pay off private lenders in the advanced countries should not be a source of pressure for official assistance. We would expect that through a review procedure, as suggested above, the IMF would examine the entire structure of obligations in individual cases and would be prepared to comment and advise on potential problems associated with all forms of debt.
WE HAVE LEFT to last the discussion of official development assistance, the element of North-South relations that usually receives the most attention. Flows of capital on grant or highly concessional terms have helped to build basic facilities in a large number of developing countries and have been a key factor enabling some to reach a path of strong growth. They continue to be large and relatively important, accounting in 1971 for about $7 billion out of a total flow of $18 billion in financial resources moving from industrial to developing countries. Without them, the debt-service problem would long since have become unmanageable.

We must recognize, however, that the amount of official assistance has been relatively stagnant over the past ten years particularly if allowance is made for price increases. This is so despite the various commitments undertaken by the industrial countries to have the amount of their assistance reach a specified proportion of their GNP. Furthermore, very little progress has been made in untying bilateral development assistance. This failure to untie bilateral development assistance not only reduces its value but also its flexibility since only untied assistance can be used effectively for program as well as project purposes. It seems evident to us that a reversal of this trend is required.

The principal reason for this lackluster record is the lagging performance of the United States, which has only in part been offset by increased assistance from other countries. Insofar as long-term, untied development assistance is concerned, none of the industrial countries has an outstanding record. Nor has the trend in development assistance from the USSR and Eastern Europe helped; it has not increased and remains a very small percentage of GNP.

Bilateral programs have been the principal vehicle for providing de-
Official Assistance

The bilateral funds, whether for technical assistance or development grants and loans, are provided mainly on the basis of special historic, cultural, or political links between donor and recipient countries. Assistance through multilateral institutions, principally the World Bank, the regional financial institutions, the European Development Fund and the United Nations Development Program (UNDP) is growing, but still accounts for only one-fifth of the total.

Countries Needing Official Assistance

A number of countries have a diminishing need for official assistance because, as noted earlier, they can tap private capital markets. They do this on their own or through what amounts to the intermediation of the World Bank and the regional financial institutions. These countries have come a long distance toward full participation in the international trading and investment system and they continue to expand at home at a rapid pace. Notable examples are Brazil, Taiwan, Korea, and Mexico. Many others with records of high and consistent growth are diversifying their economies and are becoming exporters of manufactured goods on a significant scale. It seems probable that additional countries are likely to join this group over the balance of the decade.

The principal oil-producing countries form a second category. Some like Iran are able through oil revenues to finance rapid economic expansion on their own. Others like Kuwait and Saudi Arabia are themselves a source of assistance to other countries in their region. Still others like Nigeria and Indonesia are benefiting from oil revenues, but not yet sufficiently to achieve on their own the necessary turnaround in their economies.

There are two additional categories of countries that clearly will continue to require external resources on a concessional basis.

One comprises the least developed countries—perhaps twenty to thirty in number having a total population of approximately 150 million. They are overwhelmingly nonindustrial, and they are lacking in public facilities and services such as education, transportation and communications, and financial institutions. These countries have still to develop the basic social and economic structure that will permit sustained economic expansion. There is little prospect of their being able to do this without receiving concessional assistance from abroad for a long time to come.

The other category comprises a smaller number of countries with a
28  Reassessing North-South Economic Relations

much larger total population. India, Pakistan, Bangladesh, and perhaps Indonesia and Nigeria are the largest countries in this group. Unlike the above group, these countries in the main have the basic public and technical facilities to support economic expansion and to become substantial members of the world trading community. They are burdened, however, by low per capita income and heavy pressure of population on resources. In this situation, great difficulty in effectively employing available manpower is endemic. These countries will need large-scale assistance for at least a decade, not to generate economic expansion but to accelerate the pace and to broaden the impact. Their economic prospects will primarily be decided by their own policies, which for example will determine how greatly they can benefit from increasing trade. Nevertheless, left on their own, these countries' development efforts will be very vulnerable to failure and they will have little economic margin to cope with their enormous problems of poverty and unemployment.

Moves toward Multilateral Programs

If these are likely to be the principal purposes for which official development assistance is needed over the balance of the decade how can they best be achieved?

A substantial contribution will no doubt continue to come from bilateral programs for the special reasons noted above.

The key requirement, however, will be to raise the volume and improve the quality of all assistance. That implies providing assistance that is highly concessional in character so as to minimize the debt-service burden, untied so as to maximize its usefulness, and nonpolitical so as to insure that it will go to countries where it is most needed and can be most effectively used.

This kind of assistance can be said to be the special concern of the international community as a whole, to be shared on an agreed basis. Its characteristics argue for much greater emphasis on assistance supplied through the multilateral institutions. In the case of financial assistance, this would mean the World Bank group and the regional financial institutions; they now account for the largest share of current official development lending (including loans made on near commercial terms) and they are rapidly expanding their capabilities to assume greater responsibility and leadership in this field.

We have no strong views as to how much of an increase in official assistance will be required, beyond the belief that the International Develop-
Official Assistance

The assistance Association (IDA) and the soft loan facilities of the regional institutions in particular will have to be financed on a substantially larger scale than at present. It seems to us that a guide to answering this question could be provided by a tentative estimate drawn up for a three- to five-year period by the World Bank in collaboration with a group of experts drawn from the regional lending institutions and the UNDP, and perhaps from a few lending and borrowing countries.

An estimate drawn up on this basis would not of course be binding on the governments of the industrial countries. Nevertheless it would give them a basis for seeking appropriations, a method of facilitating agreement on sharing requirements among each other, an indication of how much progress had been made, and a sense of future trends.

It is in furtherance of such a system that a connection between monetary reform and development finance could be useful. Negotiating a new monetary structure for the world affords an opportunity for further internationalizing of development assistance. One way to do this would be through use of the following procedure. As new allocations of Special Drawing Rights (SDRs) occur, the industrial countries could assign a portion of their total allocation to the IDA, for low-interest, long-term lending. Additional funds could be made available to IDA if the monetary reform negotiations include arrangements to consolidate reserves held in U.S. dollars and sterling by exchanging them for SDRs. The IMF could then turn over to IDA any net earnings it realizes from such arrangements. The amounts that might result will necessarily be uncertain since they will depend on the need for international liquidity which will be determined on entirely independent grounds. Hence we would consider these sources for financing multilateral assistance as supplementing rather than substituting for current methods.

A similar need exists to improve the quality of technical assistance so as to develop new technology and adapt it to the special requirements of the developing countries. Its basic purpose is to increase productivity, enhance employment opportunities, and improve the quality of life in those sectors unlikely to be touched for many years by either foreign investment or foreign trade. Much of this effort will have to focus on rural development. To an increasing degree the development and improvement of the necessary technology should take place within the poor countries, rather than through institutes in the industrial countries. In all of this, there is need for sustained experimentation and for improved coordination of existing technical assistance programs. This suggests a larger role for
the UN agencies and, in the case of bilateral programs, increased emphasis on forming joint international projects and on establishing independent experimental institutions whose governing boards include experts from industrialized and developing countries.

We see the above procedures as part of a process for coordinating all forms of development assistance, bilateral and multilateral, government and private. Our objectives should be to improve the degree to which all of these resources are responsive to the needs and priorities of the developing countries. We see this happening not only through greater resort to multilateral assistance but also through wider use of consortia and the formulation of bilateral programs in a multilateral context.
7 a concluding comment

In this report we have assessed separately the major elements in North-South economic relations insofar as they apply to the policies of the industrial countries. We have emphasized the possibilities for actions by the industrial countries in the fields of trade, private capital flows, and development assistance—actions that would advance the objective of economic development. It is useful now to see how our suggestions may fit within a more general perspective.

Let us suppose that in the 1970s the economies of the United States, Canada, the European Community, and Japan grow at rates more or less the same as in the 1960s. By 1980, the combined gross national product of this grouping, in today's dollars, will be $4 trillion.

Let us further suppose that our imports grow at an average rate of 8 percent per year for the rest of the decade, and that their composition does not change very much. In 1980, total imports, valued in today's dollars, will be in the neighborhood of $400 billion, of which perhaps $250 billion will be in manufactures.

We think it is a fair question to ask whether, against these conservatively stated magnitudes, there should be any doubt about our ability to buy the goods that the developing countries can produce efficiently. Or whether there should be any doubt about our ability to transfer a growing volume of development resources through public as well as private channels. The conclusion must be that we can afford to cooperate with the poorer countries abroad even as we do more to deal with our problems at home.

If, further, the hopeful signs of a lessening of East-West tensions are borne out, then we can begin—with the Soviet Union—to direct resources on a very large scale from military uses to the pressing needs of the poorer countries as well as to our problems at home.
The truth is that we have the wealth, the productive capacity, the skills and the knowledge, not to make over the world but assuredly to provide in a decade the basis for genuine hope for the future. Our potential is immensely greater than the difficulties that seem so large when we look at the matters separately and narrowly.

To set its relations with the South on a new and hopeful course, the North needs only to widen its vision.