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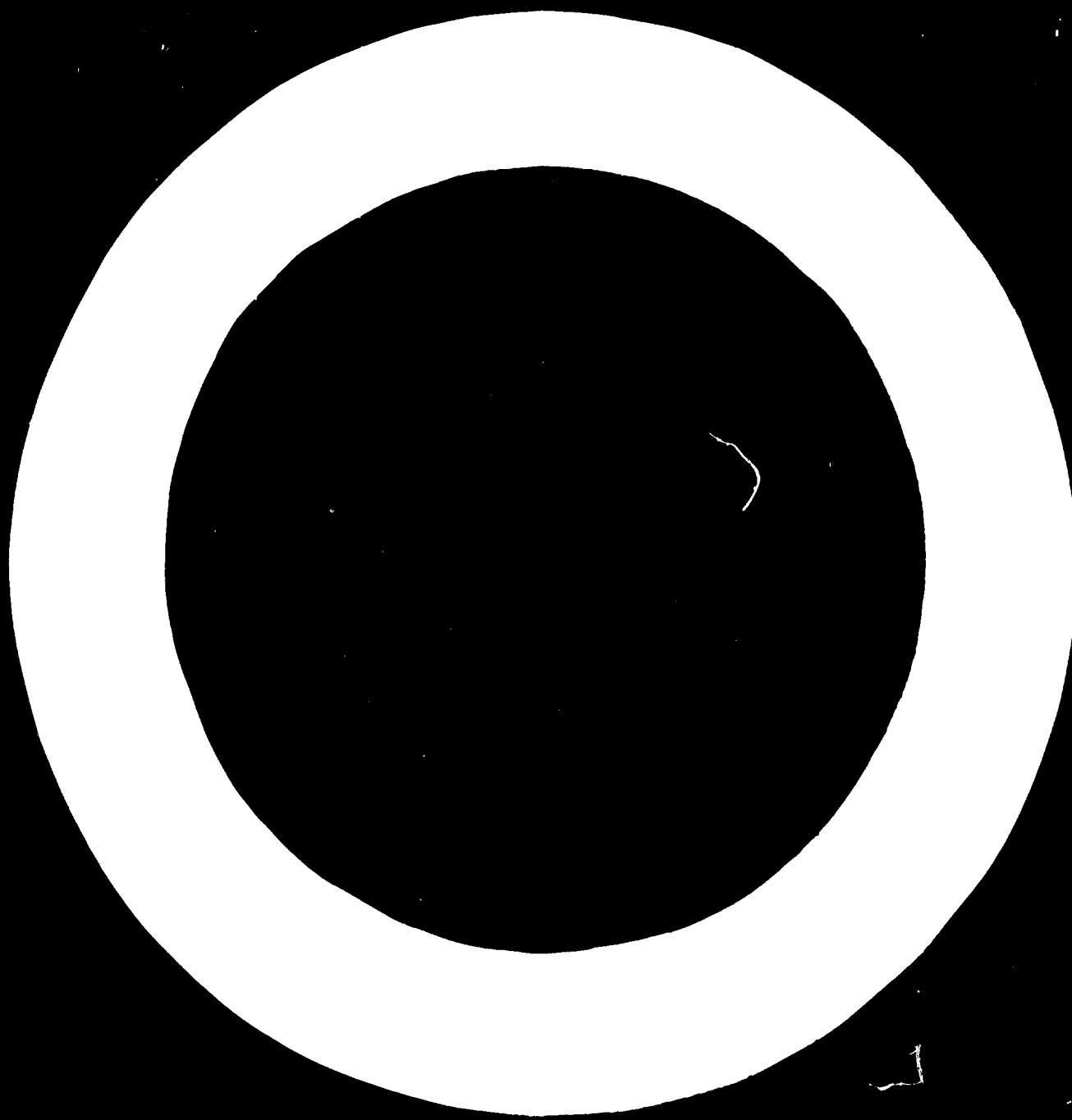
THE FEASIBILITY OF REPAYMENT OF INVESTMENT LOANS
IN THE FORM OF MANUFACTURED EXPORTS ^{1/}

prepared by the UNIDO secretariat

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Introduction

1. Foreign aid has undoubtedly played an important role in the economic development of developing countries in recent years. The problems connected with the question of how to utilize this aid with maximum effectiveness are well recognized, discussed and discussed. A number of new programs and projects have been started. But, one of the main problems, and one of the most important, stands ahead. The question of how to use the only now becoming important factor in the economic development of developing countries, that is, the problem of growing indebtedness of these countries, and the resulting burden of debt service.

2. The UNCTAD estimated the total outstanding public or publicly guaranteed debt of the developing countries amounted to more than \$100 billion in 1960, and is expected to reach \$150 billion by 1965. The total amount of private or privately guaranteed debt of these countries is estimated for 1960 to be \$100 billion. Annual debt service payments by developing countries amounted to \$10 billion in 1960 and increased to about \$15 billion in 1965. This service debt service, which absorbed some 4 percent of their export earnings during the mid 1950s, amounted to more than 10 percent of export earnings of the developing countries in 1961. It is expected that the debt service payments will increase to 15 percent of the rate of increase will be considerable. By 1965, up to 20 percent of the developing countries' export earnings may be absorbed by debt service payments.

3. The problem of debt service is connected with the face of the international economic life and represents a real matter of serious concern to all countries involved. Various ways and means seeking to ease its gravity have been suggested in different countries. They can be grouped in the broad categories:

- (a) re-estimation of the terms of repayment of such loans or credits, or extension of consolidation credits to this effect;
- (b) softening the terms of newly granted loans and credits in terms of interest rates, repayment periods, grace periods, etc.

2/ This paper is based on studies by experts from the United Arab Republic and Czechoslovakia.

3/ Report by the Secretary General of UNCTAD (Doc. TD/2/46 of 23 July, 1961).

4. However successful a solution along these lines might be, one hard fact remains - the principal as well as interest must be repaid, be it sooner or later, an externally imposed factor influencing a country's ability to service its external debt is obviously its export performance. It is, therefore, the financial flexibility of aid and trade that may provide a self-financing mechanism by these transactions. Such a mechanism is also proposed, however, that there exists a certain degree of co-ordination of both aid and trade among the countries concerned. 4/

5. One of possible proposals regarding aid and trade is that of repayment in kind. Although first proposed in at least 1940 and used by socialist countries in their economic relations with some developing countries, this fact alone in no way excludes the possibility of its broader application. 5/ The repayment may be effected in the form of goods from the production of which aid is given, such investments loans, or in the form of other commodities. In the latter case, the goods or will be directly transferred to the recipient countries and efficiency of work thereby established through costs and quality of the goods which will enter his import list. In the present paper, attention is focused on cases where repayment is made in form of locally manufactured goods.

6. The repayment of loans in kind has had a possible impact on the process of industrialization in certain developing countries. Moreover, from the point of view of trade creation, such schemes appear generally to be conducive to the expansion of trade between the partners concerned. There is, however, a lack of information on their actual scope which prevents a more serious analysis to be undertaken at present. As these procedures do, however, represent a promising possibility and, since a few examples of their application are known, they will be treated here as a method which will be illustrated by factual data whenever these are available.

4/ Broadly speaking, the following basic assumption is accepted here, although not especially discussed. It is accepted that in the long run it is more important for the developing countries to enable them to increase their export earnings than merely to provide them with foreign loans. Often it is not the volume of repayment (which, in many cases may be small in relation to the total exports by the developing country concerned), but the very fact that this sum is not to be paid in convertible currency which matters.

5/ As a matter of fact, there exist several proposals as to the procedures which may be used by developed countries with market economies in this regard. (See for instance "Light servicing as an aid to promotion of trade of developing countries" by N. N. Khakhale in Oxford Economic Papers, Vol. 16, July 1964, p. 69).

1. Credits, loans and industrialization

7. The flow of external resources to developing countries as a whole was estimated at between one-fifth and one-third of the total gross investment in these countries in the period 1950-1964. This estimate covers on the one hand all external resources, and, on the other hand, all sectors in developing countries. In the case of industrial financing, the net flow of financial resources from both developed market economies and socialist countries in the period amounted to \$10-11 billion. It appears that, out of this sum, 70 per cent was directed to manufacturing sectors in the developing countries.^{6/}

8. An analysis of all external loans and credits extended to developing countries points to the fact that socialist countries, engaged, in granting credits, a definite priority to industrial projects in developing countries, while the bulk of official credits extended by the countries with market economies was directed to infrastructure and agriculture. It is estimated, for instance, that in the period of 1960-1964, socialist countries commitments directed to manufacturing industries represented 53 per cent of the respective total amount of their bilateral assistance, while comparable proportions for the industrialized countries with market economies are estimated at about 40 per cent.^{7/}

9. State credits granted by the socialist countries of Eastern Europe to developing countries have demonstrated a clear upward trend. They amounted to US\$ 720 million on a yearly average, during the period 1961-1965. The increasing tendency is obvious, since the last two years of the 1961-1965 period are taken separately: US\$ 921 million and US\$ 1041 million in 1964 and 1965, respectively.^{8/} There are no official data concerning the actual disbursement of the credits. Estimates based on trade balance data and some national publications seem to indicate that actual use of credits by socialist countries reached approximately 50 per cent for the period of 1957-1965 and has tended to improve during the last five years. About 75 per cent of loans and credits put at the disposal of the developing countries by countries members of the Council for Mutual Economic Assistance (CMEA) were used for power, industry, metallurgy and mining and 25 per cent went to engineering, chemical industries, oil refineries and building materials industries. The remaining were used for construction of transport and communication facilities, geological surveys, prospecting, light and food industries as well as for scientific, medical and educational institutions.^{9/}

^{6/} Industrial Development Survey, Volume 1, United Nations Publication, Sales No. E.64.II.3.13

^{7/} Official External Financial Assistance for Manufacturing Industry of the Developing Countries, UN document ID/CONF.1/1.

^{8/} UNCTAD document ID/CONF.1/2.

^{9/} See United Nations, Proceedings of the United Nations Conference on Trade and Development, Trade Expansion and Regional Groupings (Sales No. E.64.II.3.17, pp. 331-335)

10. Structural distribution of the credits by individual COMECON countries reflects many factors related both to the "industrial orientation" of the creditor country and to its export capabilities in individual branches. This situation differs, naturally, from one creditor country to another.

11. The following was the structure of sectoral distribution of loans and credits granted by the Soviet Union up to 1965: to metallurgy 27.4 per cent, power industry 19.4 per cent, mining 0.7 per cent, engineering industries 12.4 per cent, chemicals and petroleum industry 6.5 per cent, building materials 1.0 per cent, consumer goods and food-processing industries 2.0 per cent. Industrial sectors participation in the whole amount of loans and credits amounts to more than 70.0 per cent.^{10/} Another major supplier of credits - Czechoslovakia - registered the following sectoral distribution in the period 1962-1967: metallurgy 1 per cent, power industry 20 per cent, engineering industries 32.0 per cent, chemicals and petroleum 15.0 per cent, building materials 10.0 per cent, consumer goods and food-processing industries 11.0 per cent, and totalling 89 per cent for the industrial sector.^{11/}

12. By 1967, two thousand industrial plants and other projects in developing countries were on the technical assistance lists by socialist countries. It was estimated that the capacity of power stations built with the aid of COMECON countries amounted to 5.2 million kilowatts, or about one-third of the capacity existing in countries in which they were built. The capacity of metallurgical plants constructed was expected to increase to 3.5 million tons of steel, thus doubling the existing capacity of publicly owned steel plants in the credit-receiving countries. The capacity of oil refineries thus built amounted to 10 million tons, which represented over 50 per cent of capacity available in the countries concerned. In the case of newly built cement plants, their capacity reached 2.5 million tons, e.g. almost 11 per cent of their existing total capacity.^{12/}

13. Obviously, neither internal spill-over effects (whose incidence it is, however impossible to measure here) should be overlooked. We refer here to such indirect effects of building-up industrial enterprises as for instance - taxes from the enterprises, purchases of local goods and services, training of local personnel, in some cases their contribution to external economies of the region, etc.

II. Institutional Arrangements

14. Investment loans granted by socialist countries of Eastern Europe are offered generally through bilateral agreements. The terms of such credits have over the years become longer, the rates of interest and the

10/ Vneshehnaya Torgovlia, No.5 and 8, 1966.

11/ Proceedings of UNCTAD, Vol. VI, Sales No.64.II.B.16

12/ IBID.

amount of advance payments and those due at the time of shipping have been gradually lowered. The credits carry, as a rule, an interest rate of 2.5 per cent and are repayable over a period of 10-15 years, beginning one year after the completion of the project or of deliveries of machinery and equipment. The interest accrues from the date of commencement of each fraction of total credit. Both the principal and the interest are generally repayable in the form of commodity exports of the recipient country, or, under special agreement, in either local or convertible currency.

15. The most widespread form of repayment so far has been that of traditional exports of commodities. In a number of cases, however, repayment is being effected through exports of goods produced by the plants and factories built with the aid of the credits concerned. It is especially this specific feature that may form a basis of an economic mechanism which would stimulate continuously the developing country to promote its industrial exports in repayment of investment loans as well as the creditor to make room for imports thus increased. Consequently, import substitution would be combined here with the encouragement of exports through the assurance of workers.

16. An illustration of international arrangements just mentioned can be found in the Agreement on Economic Co-operation between the Government of the Czechoslovak Republic and the Government of India signed on 24 November, 1954. The Agreement deals explicitly with deliveries of machinery and industrial equipment for the plants enumerated in its Article Two. The terms of credit are set in relevant articles as follows:

"The Government of the Czechoslovak Republic will make available to the Government of India a credit up to 23.1 crores Indian Rupees.....in payment of the F.O.B. value of deliveries effected from Czechoslovakia to India the credit shall bear an interest of 2 1/2 per cent per annum the amount outstanding after the completion of deliveries for corresponding plant shall be divided into eight equal yearly instalments. The first instalments for the repayment of credit shall be paid upon the expiry of one year after the presentation of the final invoice... in respect of the last delivery of machinery and equipment for putting the plant in question into operation

Article Eight of the Agreement makes it clear in addition, that the general idea was to repay the credit in goods.

13/ In recent years a new form, "government commercial credit" has appeared. Although these credits are also granted under government-to-government agreements, their use depends on contracts between individual firms and organizations. The interest rate of such credits is somewhat higher - up to 4 per cent and the repayment period is normally 3-8 years.

17. The Second Agreement on Economic Co-operation between the two Governments signed on 11 June, 1964, reflects a change in softening the credit terms. First of all, the repayment period has been extended to 17 years instead of eight. Furthermore, two additional features have been incorporated into the Agreement:

"The amount referred into the above account shall be utilized for purchasing machine goods for export to (Czechoslovakia) ... The prices of goods to be purchased and sold under this Agreement would be based on world market prices ..."

18. While the former reiterates the bilateral character of mutual trade, the latter is apparently directed toward safeguarding against a difficulty which may arise in this connection. Left without strict continuous control by both partners, the price under a bilateral agreement may tend to rise above a level generally recognized as world market prices.

19. Similarly, but more explicitly, the Agreement on Economic Co-operation between the Government of CzeS and the Government of UR, specifies the kind of repayment as follows:

"Installments due shall be paid ... by the proceeds from deliveries of goods from the UR and to the CzeS ... in accordance with the Trade Agreement and Payments Agreement in force between the two countries".

III Technical Assistance - a part of the scheme

20. Another important feature of these arrangements is the fact that the creditor country assumes responsibility for the practical implementation of the aid programme. Under such arrangements, the project is normally handed over as "turning" plant, factory, etc. This includes technical assistance, which is offered as an integral part of the project financed.

21. As a rule, technical know-how, expertise and various forms of training of national personnel of the recipient country has been provided. On-the-job training of engineers and other qualified personnel, facilitated by the presence of engineers and skilled workers from the donor countries has frequently been reported to enable the recipient countries to continue the construction with their own labour. Similarly, a considerable number of technicians from developing countries are being trained in the donor countries in units similar to those under construction. 14/ Whenever necessary, technical assistance may also be directed towards adjusting production in the developing countries to technical standards and/or consumer habits in the importing country or countries.

14/ According to Soviet sources, about 100,000 skilled workers and technicians have been trained in recent years in the Soviet Union alone.

22. One more element, this time of an institutional nature, should be mentioned in connection with the realizations of schemes described above. As it is to be expected in any undertaking involving international co-operation, difficulties may arise at one stage or another of its implementation. In order to avoid them, several inter-governmental committees have been established in many bilateral relations and entrusted with the task of conducting co-ordinational survey of economic co-operation under international bilateral agreements. These are, as a rule, high level committees which may become an efficient tool for both ensuring proper realization of existing agreements and exploring opportunities for new economic co-operation on the basis of long-term plans and programmes. As a rule, expert groups are being established by these committees to examine in detail the possibilities of complementary structures within individual industries or sectors.

IV. Consideration of some specific examples

A. The case of the United Arab Republic

23. Several agreements on economic co-operation have been concluded between the UAR and socialist countries in the sixties. The share of socialist countries in the total foreign aid was, in mid-year 1967, 55 per cent for \$1,300 million. The credits have been committed mainly to industry and land reclamation schemes. They bear a simple interest of 2.5 per cent per annum. Five per cent of the F.O.B. value of each delivery of machinery equipment, etc., is to be paid within 90 days after the presentation of shipping documents. The remaining 45 per cent of the F.O.B. value is to be repaid, mostly in goods, within 7-12 years depending on the nature of projects involved. Along these lines, agreements on economic co-operation have been concluded between the United Arab Republic and Bulgaria, Czechoslovakia, Eastern Germany, Hungary, Poland, Rumania, the Soviet Union and Yugoslavia.

24. Under the Agreement of October 1965, a credit of \$1 billion has been committed by Bulgaria. Complete industrial plants and equipment to be delivered include: solvent extraction plants for cotton seeds, ground nuts and soya beans, animal fodder plants, concentrated fruit juice plants, starch and yeast production, porcelain production, etc.

25. Two agreements have been concluded with Czechoslovakia - first one of March 1963, amounting to 20 million pound sterling and supplemented by additional 2 million pound sterling in March 1965 and the second, of March 1965, with the credit commitment of 25 million pound sterling. The credits cover mainly such projects as construction or expansion of sugar factories, cement plants, leather and shoe factories, diesel engines, tractors and trolley buses, plants, textile factories and also the delivery of equipment for chemical, petroleum, telecommunication and pharmaceutical industries.

26. A credit of 25 million pound sterling has been extended by the German Democratic Republic under the Agreement of March 1965. Credits have been committed mainly to the development of metallurgical, metal-working, chemical and construction industries.

27. Two Agreements on Economic Co-operation have been concluded with Hungary. The credit extended by the first Agreement of October 1962 (10 million lang) has been utilized already. A second agreement, concluded in February 1966, carries a credit of 15 million pound sterling to be directed to food industries, chemical industries and transportation.

28. Under the Agreement of December 1954, a credit of US\$ 20 million has been extended by Poland. The aid was directed to copper and aluminium industries, fertilizers' production, machine tool industries, etc.

29. Romania has co-operated in projects for the chemical, cement and mining industries, oil and gas production as well as in projects directed to transport services.

30. Three Agreements on Economic Co-operation have been concluded between the USSR and the UAR. The first one, of January 1958, contained a credit of 300 million roubles, that of June 1963 amounted to 70 million roubles and the third one was negotiated in 1964, with the credit of 252 million roubles. With these credits, metallurgical industries development, electricity and irrigation projects, machinery and chemical production plants were to be financed.

31. In some cases, industrial based agreements in conformity with the recommendation adopted by the 1964 United Nations Conference on Trade and Development 1 have been concluded. These agreements foresee direct repayment of investment loans in the form of goods originating in the plants built:

- (a) The agreement with Poland (December 1964) extends an investment loan of US\$ 20 million. Poland undertakes to deliver machinery, equipment, know-how and technical services for the mining industry in the UAR. One of the projects to be executed under this agreement is the expansion of the production of phosphate concentrates to attain, in two stages of development, production capacity of 800 thousand of concentrates per year. In turn, the UAR undertakes to supply Polish importers with phosphates of the same value. Deliveries are to be effected in a ten-year period 1965-1975.
- (b) Under the Agreement on Economic and Technical Co-operation with Romania (1964), the latter would supply machinery and equipment for the following industrial projects in the UAR:
 - mining and concentration of phosphate ores plant to reach the capacity of 1 million tons of crude ore, and 600 thousand tons of concentrates per year;
 - soda ash and caustic soda plant with capacity of 100 thousand tons per year of raw sodium bicarbonate;
 - delivery of 40 diesel electric locomotives to be used for the transportation of iron ore, etc.

The goods to be delivered as repayment of the investment loan are iron ores, phosphates and a substantial portion of the production of the soda ash plant.

- (c) A contract was also concluded in 1967 between Invest Export, Berlin, German Democratic Republic and East-Szechuan Iron Works and Heavy Machinery, on the creditor side, to ensure the delivery of machinery and equipment for a certain enterprise with the following conditions: the payment to be effected in seven yearly instalments of 100,000 marks each and interest on production of 10 per cent. Generally, about 50-60 per cent of the total production is exported to the German Democratic Republic in repayment. The last instalment was paid in December, 1967. As a matter of fact, this has not yet been the only deal concluded in the USSR with the investment loan to be fully repaid with manufactured goods produced in the socialist camp.

32. Foreign assistance extended to the USSR by the socialist countries proved, according to the USSR reports, to be most fruitful. The best results are achieved in such projects where raw materials, know-how and labour was available to the USSR. Projects that enhance a high share of imported raw material or components, technologies that are completely unknown to the labour force or use especially sophisticated know-how prove, as a rule, more difficult to accomplish and special care should be taken in their preparation. In cases where production is being exported to secured markets, much depends on complementarity of the import structure of the countries involved on both sides.

4. The case of Czechoslovakia

33. Taking Czechoslovakia as a base or country, the relations with two partners have been examined, namely India and the USSR. Since in the previous chapter we have dealt mainly with the investment loan-production aspects, we shall here take a closer look at the second aspect, namely that of loan-trade.

34. In the first half of the sixties, the economic co-operation between Czechoslovakia and both India and the USSR has already been developed to a certain degree. The credit agreements have become a central instrument in these relations. The scope of credits has, moreover, become an increasingly decisive factor in relation to the volume and, subsequently, also to the structure of mutual trade.

35. Thus, exports from India to Czechoslovakia, increased between 1960/61 - 1965/66 from Rs. 70.8 million to Rs. 158.2 million, that is, more than doubled. Within this period, however, Indian exports of raw materials and foodstuffs increased by 49 per cent while the exports of manufactures and semi-manufactures more than quadrupled (the share of the latter in total exports was 1.7 per cent in 1960/61, while in 1965/66 it came to 35 per cent.)

36. Along with a considerable increase of textile exports, entirely new items, such as plastic materials, machinery, tools, tubes and tyres, appeared on the Indian export lists to Czechoslovakia. Moreover, Indian tyres and tubes have been used for Czechoslovak tractors exported to other South-East Asian countries. Besides, the share of semi-manufactures

with higher degree of processing has increased as well. Hides and skins, as compared with leather can be cited as an example. Out of the total exports of hides, skins and leather in 1960/61, the latter's share was 2.4 per cent. In 1964/65, this share increased to 7 per cent while the rate of increase of this group of exports as a whole was 47 per cent.

37. At present, further studies are being undertaken in respect of the feasibility to harmonize development plans in various industrial sectors in India and Czechoslovakia. The aim of this effort is to seek complementarity in production programmes of selected sectors and, possibly, suggest appropriate remedial measures for both Czechoslovakia and India to this end. Periodical studies are further being carried out on potential Indian export items to satisfy Czechoslovakia's needs. These items include also such goods whose production in Czechoslovakia may have to be restricted or even stopped to make room for supplies from India. Included in these studies are such items as selected machine tools, auto auxiliaries, home light and engineering goods and leather manufactures.

38. The Inter-governmental Committee on Economic Trade, Technical and Scientific Co-operation between Czechoslovakia and India recommended that a series of studies be made on the feasibility of setting up of new joint ventures in India that would be based primarily on local raw materials. This includes also a study of the possibilities of mutual co-operation in various projects in third countries.

39. Similar developments may have been observed since 1960 in the relations between Czechoslovakia and the UAR. Here too, credits granted by the former country have been of prime importance from the viewpoint of the structure of the UAR's trade. Towards the end of the fifties, cotton was responsible for at least 60 per cent of the UAR exports. The only item of semi-manufactured character - cotton yarn - did not account for more than 5 per cent of total exports and there were virtually no manufactured exports to Czechoslovakia at that time.

40. Bearing this in mind, one cannot overlook the 40 per cent share of manufactures and semi-manufactures in the total exports to Czechoslovakia, reached already in 1964. In 1965, certain non-traditional export articles appeared on the Czechoslovak market, e.g. textile and leather products, brandy, cigarettes, household appliances, car batteries, etc. They are responsible now for about 10 per cent of total exports.

41. From the creditor's side, complementarity of economies of countries concerned is evidently the main pre-requisite for developing efficient and practical repayment schemes. In neither case examined here the complementarity existed before, it is to be gradually developed through efforts of both partners, mainly through the promotion of such economic policies that are conducive to closer economic co-operation. In many instances, these developments on the side of donor country lead to a decision to cover increasing needs in certain products, wholly or partly from new sources of supply (the old sources of supply include both domestic production and established channels of imports).

G. Some other factual or potential cases.

42. Examples given in preceding sections A and B are in no way exhaustive in the sense of the coverage of existing cases. In fact, fragments of information on numerous other factual or potential cases of repayment of loans in the form of manufactured exports appear in national publications or other sources.

43. It has been reported, for instance, that a new lamp factory is being built in Teylon on credit extended by Hungary. Exports from this factory are directed to Hungary and to third countries. In India, the prospects were bright for setting up the shoe factory, out of whose future production 3 mill or pair of shoes would be exported to the USSR.

44. Another case refers to a tractor plant to be built with the assistance of Romania in Iran (capacity of 10,000 tractors per year). Repayment in the plant's production is envisaged. Tyre factories to be set up with the assistance of Czechoslovakia in the GDR, India, Algeria, Indonesia and Cambodia may represent another example in which repayment in exports of the goods produced by the factories concerned are envisaged.

V. Some questions of policy

45. The economic interests of developing and socialist countries would seem to converge to a considerable degree in the sense that along with the process of industrialization, both existing excess capacities and newly planned capacities in some industries of the developing countries could be utilized and help satisfy the expanding demand in the latter countries. The procedures briefly discussed in the present paper seem to be capable of helping to achieve both purposes mentioned above. Their positive influence would seem to enhance both the sphere of production and the sphere of trade. These schemes are capable of stimulating the process of industrialization of the developing countries through industrial co-operation. At the same time they work towards diversification of the developing countries' exports and generally have a trade creating effect. Last but not least, they involve trade promotion effect in creating markets for new products from developed countries which would otherwise require considerable efforts on the part of these countries to be achieved through trade missions abroad, etc.

46. There is no doubt, however, that there exist both problems and limitations inherent in them. The first problem in this connection is that of pricing both the flow of investment goods and services into the developing countries as well as the outflow of goods used for repayment. Here, the introduction of "world market prices" clause into the respective agreements, with due regard to the quality and technical as well as functional standards of the goods involved, is of basic importance.

14. One of the main criticisms voiced by the developing countries is that of the "tying effect". To be precise, this criticism does not apply to the described method exclusively; it is a general plea for "untied" aid voiced in the circumstances when the share of "tied" loans

16/ (Contd.) and credits, be it in relation to projects, suppliers or both, is constantly growing due to many factors. It is known that, for instance, all loans by the Export-Import Bank and most loans of AID were directly tied to the purchase of US goods, nine-tenths of loans extended by international organizations were directed toward financing a specific project and virtually all loans by socialist countries were "tied". The argument against "tied" aid basically is that this tends to diminish the flexibility of the transfer, may involve higher costs resulting from limited or non-existent competition among different suppliers and, consequently, may lessen the real benefit derived from the transfer.

Under the conditions of general non-convertibility of currencies used in these arrangements, any effort towards multi-lateralization of the procedures discussed, be it on the side of credit extension or through the use of multilateral institutions for delivery of investment goods, might add additional requirements as far as the pricing and quality of investment goods is concerned. Institutionally, one can also conceive of gradually developing such schemes which would use roubles that are convertible, through negotiations among the COMECON partners concerned for extending loans or credits, possibly through the COMECON International Bank. Such schemes may prove of particular interest if accompanied by gradual progress approximating price levels in the socialist countries to world prices.

47. The limitations inherent in the foregoing schemes stem from manifold reasons and the potential volume of these schemes depends ultimately on both the quantity and quality of the elements of complementarity. 17/ It is obvious, for instance, that strong competition exists in socialist countries between extending loans and credits and financing their own investment programmes. Furthermore, the quality of goods used in repayment must be accepted on the markets of creditors and the goods themselves must enjoy an appropriate amount of foreign demand primarily, but not exclusively, in the creditor country, if the scheme is to lead to an expansion of trade. The exports should not cease after the credit or loan is repaid, and should continue on a commercial basis. It is obvious that not every export item is capable of complying with such a requirement.

17/ Throughout the present paper, the socialist countries are being treated as an economically homogeneous group. This is justified only by the level of generality adopted here. Any meaningful examination for practical purposes would have, however, to take at least into account the quite specific economic structure and development patterns of the USSR on one hand, and of other socialist countries on the other hand. Actually, present and potential import capacity and patterns, as well as the criteria of economic complementarity will differ from one socialist country to another.

43. In many socialist countries, responsibilities have recently been passed down to enterprises which have been given greater independence in decision-making. Logically, there will be only limited state interference with their cost and profit calculations and with their choice of export markets or sources of supply. This can be implied, that multilateral criteria should be considered to play a more active role in selecting future projects on the one hand and greater attention to weaker relative advantages of domestic investments as compared with imports on the other hand.

44. Disproportion fluctuations in the foreign trade of socialist countries can create unfavourable 'chain reactions' within the planned economy. Moreover, balance of payments considerations make it necessary to balance current imports by adequate export earnings. In order to sustain foreign trade as an integral part of a planned economy, the socialist country usually prefers that the level and composition of foreign trade to be determined with a certain degree of reliability and certainty. Here, a number of problems may have to be dealt with, including the ways and means of protecting creditors from devaluation risks.

45. In a developing economy, on the other hand, a large project in any sector is bound to have both direct and indirect effects on other sectors, both in terms of derived input demand and in terms of the increased supply. Indirect effects can be far-reaching and their conclusion from the analysis may result in gross over- or under-evaluation of the project itself. There is a common plea for economic interdependence of investment decisions, even when individual projects are technically reasonable. Broadly speaking, this is the most convincing argument for establishing a very close inter-relation between the individual projects to be executed with foreign assistance in the developing country concerned and the country's development programme or plan as a whole.

46. Taking both partners' basic requirements into account, one prerequisite may be derived from the policies to be followed. If this form of assistance is to be mutually advantageous, it must be ensured that the project has its defined place in the development plan of the developing country concerned and, too, must be viewed as an integral part of the complementary efforts by the socialist country or countries concerned.

47. The methods of repayment by exports of local manufactures have recently received international recognition and, in fact, new encouragement. Resolution 15(II) of the Second Session of the United Nations Conference on Trade and Development recommends, inter alia, that socialist countries: 12/

12/ UNCTAD Second Session, Volume 1, New York 1968 Sales No. E.68.II.D.14 p.33

"..... take into consideration when extending credits for the financing of projects in developing countries the particular conditions of the countries concerned and make priorities, where appropriate, for their repayment by the export of the products of those projects or other products"; and

"In the light of the recommendation in Annex I.II.2 of the First Act of the First Session of the Conference, encourage conclusion of industrial branch agreements or partial division of labour, providing, inter alia, for the supply of plant and equipment on credit to the developing countries accepting repayments of the credits, in particular, with the goods manufactured by these plants in the developing countries concerned..."

The same resolution recommends, among others, that developing countries:

"...adopt their exports to commercial specifications required by their trading partners; and

"grant to these countries conditions for trade not inferior to those granted normally to the developed market economy countries."

VI. Prospects for Future

53. The potential of such schemes for future depends, obviously, on many factors. On the creditors' side, the most important of them is the capacity by socialist countries to supply investment goods and equipment for projects to be built up in developing countries. On the side of debtor countries, the conclusion is obvious in this particular connection. Namely, the demand of developing countries for imports of machinery and equipment will be growing. The following estimates have been made by the GATT Secretariat: ^{19/}

<u>Industrial equipment requirements by the developing countries</u>		
	(in millions of dollars)	
	<u>1965</u>	<u>1975</u>
Latin America	3,300	6,300
South-East Asia	1,900	6,300
Africa and other regions	3,000	5,000
	<u>8,200</u>	<u>17,600</u>

54. The importance of socialist countries as suppliers of investment goods is becoming increasingly apparent. At present, the socialist countries have come to a point when further growth may be accelerated if closer, broader and more stable economic links with the rest of the world can be established. The engineering industry has traditionally

^{19/} GATT, International Trade in 1961

been one of the most dynamic sources of growth in socialist countries. These countries rank among the main world producers of a widening range of machines and equipment. In 1958, for example, combined engineering production in Czechoslovakia, Hungary, USSR, Poland, the GDR, is estimated to have been more than two-thirds of that of the Federal Republic of Germany, France, Italy, the United Kingdom, while in 1950 it was under one-third.

55. On the export side, however, it is to be noted that the socialist countries will be able to furnish an increased share as well as volume of machinery, equipment and other investment goods to developing countries. An increase of use of investment goods in their exports to developing countries would, however, call for an increased amount of grant financing, whose supplies of course, far from unlimited.

56. Repayment of credit is also possibly to be considered rational in such cases where socialist countries could be benefited as a result of their extension. It would seem that not an insignificant part of the economic demands of socialist countries can be, under a sort of loan-lease arrangement (including those considered in the present survey), supplied by developing countries.

57. As far as the more traditional manufacturing activities in developing countries are concerned, such spheres as just manufactures, cotton cloth, ready-made clothing, footwear etc. can be mentioned as potential areas to build upon. For the developing countries it may have an immediate prospect of realization the advantages of both economies of scale and those of converting this output into purchasing power with which the capital goods needed for accelerated economic growth could be imported. To the socialist countries, it may offer the possibility of a more rational and efficient utilization of their investment resources and skilled manpower.

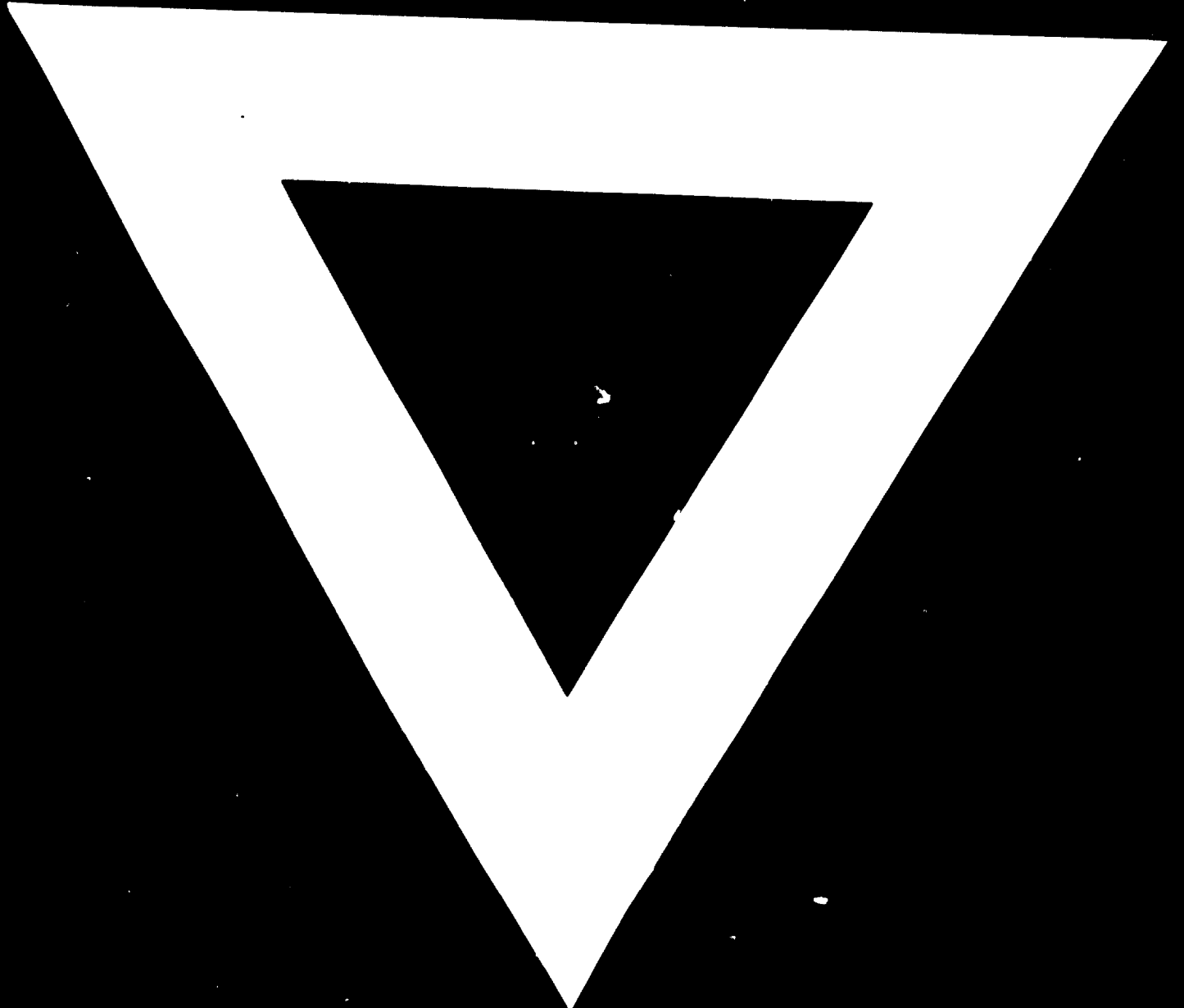
58. In the case of more capital-intensive sectors, the field of metalworking or engineering industries appear to be particularly suitable for long-term agreements on specialization and co-operation in manufacturing. The enterprises in developing countries could begin producing simple tools, machinery and other components in the first stage, and, along with gathering gradually more experience and improvement in technical standards, they could embark upon more complex production culminating eventually in finished products for domestic markets of both partners and for export to third markets. Some branch of chemical industries and high technology could be another potential candidate for such schemes.

59. When considering possible expansion of the scheme based on repayment of loans by exports of local manufactures from developing countries (both in volume and range of manufacturing activities), the answers to the following questions may help in formulating future actions in this field.

- (a) are the schemes, as briefly described, considered adequate to the results desired to be achieved by the partners concerned?
- (b) could introduction, for instance, of multi-lateral element improve the prospects for such form of promotion of export-oriented industries in developing countries?

- (c) are there any other promising industrial sectors, branches or lines of products that have not yet been analyzed from the point of view of their suitability for repayment schemes?





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