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CHANCELLOR OF THE EXCHEQUER

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Development Policy

1. In my minute of September 19 I promised to let you have a note in response to the paper on development policy that you circulated on September 2. I now attach our paper and look forward to an early discussion with you and others on this important topic.
2. I am sure we all agree that the time is right to consider what our approach should be to that aspect of development policy where we, as a Government, can exert direct influence, namely the provision of official assistance. Preparations for the Ottawa Summit (where aid and other contributions to development will be one of the subjects for discussion) are already under way, and in the OECD and elsewhere it is plain that the problems of the poorer developing countries are already shaping the responses of the major donors. Your own reflections, following your meetings in Bermuda and Washington, will be of particular value to our discussions.
3. As I suggested in my minute I believe that the best way in which we, together with John Nott and Keith Joseph, can take this forward would be through the informal kind of meeting that Ian Gilmour had when dealing with the Aid Framework last month. If you and other recipients of this minute agree, I suggest we try to hold such a meeting early next month.
4. I am copying this minute to the Prime Minister, other members of OD and to Robert Armstrong.

C
CARRINGTON

Foreign and Commonwealth Office
20 October 1980

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DEVELOPMENT POLICY

1. The Chancellor of the Exchequer circulated a paper on 2 September about our development policy and the role of aid. Despite the recent Review of Aid Policy there is certainly still room to consider further wider aspects of development, and the way in which we can most persuasively present our views internationally. The transformation of the energy situation, OPEC'S new financial power, and rather greater pessimism about economic prospects for the coming decade combine to create a new context for the 1980s. The ritualistic conflict between North and South, which has gone on from 1974 on the basis of the developing countries' demands for a NIEO, is largely irrelevant but shows no sign of abating. We cannot unilaterally terminate it nor can we opt out. So we need to work out an approach to the very real problems of the developing countries which is coherent and consistent with our own national policies and also avoids our being isolated from our main partners or identified by developing countries as the least sympathetic to their needs.

2. This paper considers in turn some questions relating to the development process as well as the international dimension. Some policy conclusions are at para 18 below.

Development in the Third World

3. We agree that we should work for a wider understanding of the development process including, in this context, a clearer definition of the role of development assistance. There is general agreement that the prime responsibility for development rests with each developing country and that investment depends in the first place on the mobilisation of domestic savings. As the Chancellor's paper points out the record of most developing countries is in fact impressive; World Bank estimates are that even the poorest countries, taken as a group, may have financed up to 90% of their investment from domestic resources this year although, of course, for many within this group the reliance on external resources, largely on concessional terms, is much greater than this. Appropriate domestic policies are also of great importance to ensure that productive investment takes place and human resources are effectively mobilised.

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4. We agree that there are very wide differences between developing countries. It would be right to continue to make this point in a constructive and illustrative way so as to avoid any impression that we are simply trying to split the developing countries. It has also long been recognised that there are implications for the kind of external finance that is appropriate for countries at different stages of development.

5. The upper and middle income countries have more balanced economic structures, a higher level of skills and many have experienced high growth rates over the last quarter of a century. In general, they have been able to borrow substantially on the world capital markets and to attract direct foreign investment and technical expertise. In 1978 over 90% of non-concessional flows went to countries with a per capita income of \$400 and over and nearly 2/3 to countries with a per capita income of over \$1 thousand. Five countries (Brazil, Mexico, Venezuela, Algeria and Argentina) accounted for about half of all bank lending to developing countries and also for about half of all bond issues.

6. Unfortunately, the majority of developing countries are at the other end of the spectrum -- often with fewer resources, weaker administrations, lower levels of skill and greater vulnerability to world trading conditions. Their growth rates (in terms of income per head) have been much lower than in the middle income countries and they have naturally been unattractive to foreign investors. Mismanagement may in certain cases have played some part, but to ascribe to it the major role would be to caricature the real situation.

7. The Treasury paper itself brings out the needs of the poorest countries for continuing levels of official concessionary assistance. For these countries growth prospects remain bleak. The World Bank's Development Report contains projections indicating that they are unlikely to grow by more than 1.7% per head per year in the period 1980-85, compared with prospects of 2.6% or more for the better-off developing countries and industrialised countries and even this will only be attained if aid flows treble in current prices during the 1980s and support from the multilateral institutions is increased correspondingly, and if the share of low income countries in bilateral aid

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from the industrialised countries increases from the present 40% to around 50%. In his speeches to the Commonwealth Finance Ministers' meeting and the IMF/IBRD Annual meeting, the Chancellor emphasised that concessional aid needs to be concentrated increasingly on the poorer countries. Our own record on this score is good - according to DAC figures for 1978 72% of our total aid (including multilateral) went to the poorest countries as against a DAC average of 60% and on bilateral aid alone we score equally well. We believe that we should continue to give priority to the poorest countries in our aid programmes and to seek wherever possible to concentrate international discussion more on distribution than on volume. This need not conflict with our other aims of giving more emphasis to political and commercial aspects - there are important markets and political interests to be protected in the poorer countries.

8. We all agree that official aid should be transitional in character, and some well known cases (eg Korea, Malaysia) have already graduated from being dependent on aid for satisfactory development. Nevertheless, it is plain that for the majority of the low income countries that transitional period will be a very long one.

9. The recent rapid increases in the price of oil have seriously exacerbated the difficulties of the poorest and have greatly reduced the capacity of industrialised countries to help. It follows that OPEC should do more to channel a greater proportion of their surpluses to the non-oil developing countries. These are, of course, deposited in the world banking system and are available for recycling to developing countries. However, the extent to which they are lent to third world countries depends on the latter's creditworthiness and there are limits to the risks that financial markets are willing to take.

10. We must therefore look to the oil producing surplus holders to make a major direct contribution - either by increasing their official assistance to the poorest both bilaterally and through the multilateral development agencies or by greater direct lending to the international financial institutions (IFIs).

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The problem, however, is how to persuade them to co-operate. Attempts to pillory them will be quite ineffective and will simply reduce the prospect of achieving the co-operation which we shall need in the fields of both oil and finance. There are two chords which might strike some response - their own interest in the stability of the world's monetary and financial system, and their political identification with the developing countries.

11. We should be ready to recognise that official concessional flows from OPEC countries are already substantial in relation to their GNP and in this respect their performance is better than that of the OECD countries as a group. However, the flows are highly concentrated on relatively few countries. They should therefore be encouraged both to increase their concessional aid and improve its distribution. It will be for other developing countries to make the most of the running here but the western donors can make some contribution through co-financing in appropriate cases as has already been happening. They should also be encouraged to channel more funds through the international financial institutions. We shall have to recognise however that this could well lead inexorably to a growing influence of the major OPEC donors in the running of multilateral institutions. We must also recognise that it is implausible to envisage increased OPEC flows replacing flows from OECD countries whether bilateral or multilateral. Indeed, experience with IFAD shows that a readiness to increase contributions by OECD donors is likely to be a pre-condition of obtaining extra finance from OPEC. If a new energy affiliate is established by the World Bank the same problem will arise and it is likely to come up with the next replenishment of IDA. We can and should look for ways of improving the OPEC share of financing of multilateral institutions (and also of providing extra resources to some of these institutions without having to put up new paid in capital). But it will be virtually impossible to achieve this result if Western donors as a whole are unwilling to go on increasing their own contributions. This in turn will make it harder to achieve our own policy aim of reducing the multilateral share of our aid programme.

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12. Having emphasised the importance of private flows - mainly to the better off developing countries - there is not much more that Government can do to promote them. We have removed all exchange controls. We provide incentives to direct private investment through our investment insurance scheme reinforced where possible by bilateral investment protection agreements and by double taxation agreements. We are the second largest source of direct private investment to developing countries. The direction of private flows depends primarily on the creditworthiness and future prospects of potential recipients in the eyes of lenders and investors. We cannot expect to get all that much credit from most developing countries from the intermediation of OPEC surpluses through the United Kingdom banking system which accounts for by far the greatest part of private flows, although it should be recognised that the United Kingdom's financial institutions are carrying the risks that OPEC lenders are unwilling to bear themselves.

International Dimension

13. Whatever view we may take of the relevance of many of the developing country demands, the underlying economic position of many of them is, as the Chancellor said in Washington, very serious. They look to the developed countries for understanding of their real needs and for practical assistance. Failure to take account of this will affect the political relationship between developed and developing countries. Conspicuous lack of concern on Britain's part would single us out for criticism and resentment; there would in due course be repercussions on our political and commercial interests.

14. Underlying our development policy world-wide is the recognition that Britain occupies an unusual, if not unique, position in the world. We are the only major industrial power which both trades a high proportion of our GNP - some 30% - and also trades virtually world-wide. The only other major industrial power which approaches our share of GNP traded is Western Germany, but in their case a significantly higher proportion of their trade goes to other EEC countries or to their neighbours in EFTA. The Japanese and Americans by comparison trade only 10% of their GNP

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15. This does not mean that we must accept uncritically the partial and distorted approach of some developing country spokesmen. It does, however, mean that we should be cautious and that we should, as far as possible, act in company with the like-minded among our main partners. It would be quite unrealistic, for example, somehow to opt out of discussions that are superficially on a North/South basis. The developing countries place great store by their political unity and would react very strongly to overt attempts to divide them. Nor would our partners agree that such a course was realistic.

16. One issue to which we all attach importance is the preservation of the integrity of the international financial institutions. Here we must be firm on essentials but we must also be prepared to react positively when sensible proposals for change in policies and procedures of the IFIs are made. They have shown their ability to adapt to changing needs without compromising their essential character. We should show ourselves ready to support new ideas for making greater use of them as we have recently done over structural adjustment lending by the World Bank and expanded lending by the IMF. Where we cannot ourselves contribute we should not obstruct useful proposals made by others. Where we have genuine doubts (eg on the new energy affiliate) we should not be the first to object or the last to agree if the general view is in favour. There will have to be changes in policies and procedures. The developing countries and OPEC must gradually increase their role though not to the point of destroying the institutions. Our influence in these bodies is such that we can and should play a major role in encouraging their constructive evolution.

unless the arguments for doing it are overwhelming.

17. There will soon be an opportunity to discuss these issues frankly with our partners in the context of the study on aid issues commissioned by the Venice Summit. Clearly, action taken in conjunction with our main partners would be much more effective and would leave us much less vulnerable to criticism, internationally and domestic.

/Policy Conclusions

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Policy Conclusions

18. A number of conclusions may be drawn from the foregoing.

- i. We should seek a wider understanding of the development process, placing overseas aid in context and giving due emphasis to other important factors such as private flows.
- ii. We should act in concert with our main partners to reduce our exposure to false charges of unconcern and to demonstrate the ways in which collectively and individually we have assisted development in the third world.
- iii. We should explore practical and effective ways of persuading the oil producing surplus countries to make greater direct financial contributions. In particular, we should consider new mechanisms (for example co-financing; the extension of the Supplementary Financing Facility (SFF) etc) by which additional OPEC funds might be attracted to the IMF and to the multilateral development agencies. We should be ready to recognise that this would mean an increase in their influence in these institutions.
- iv. We, in concert with other OECD countries, should recognise a continued responsibility to make available an increased volume of concessionary finance to low income countries. This will be especially important if OPEC are to be persuaded to do more, both in general and for these recipients.
- v. We should seek the most effective use of official assistance in terms of development in order to facilitate the graduation of recipients towards eventual reliance on private finance:
 - a. by giving special attention to aid which most effectively improves food and industrial crop production, exploits new and renewable sources of energy and which enhances local skills and administration;

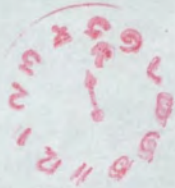
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- b. by ensuring that these funds are mainly devoted to longer term development projects and programmes; this should be facilitated to the extent that the IMF has both more funds and greater flexibility to tackle short-term balance of payments difficulties;
 - c. once the general capital increase is achieved, by supporting ways of expanding IBRD lending at minimum outlay of new concessional funds by considering either a reduction (possibly to zero) in the paid-in element of new capital or a change in gearing. This would have the additional benefits of being commercially attractive for Britain and of making the optimum use of an efficient development agency. It should also help to induce OPEC to greater efforts.
- vi. We should encourage an expanded flow of foreign direct investment while recognising the limits of Government influence in this field.
- vii. We should maintain an open trading system and should press the upper income LDCs to do likewise.

Foreign and Commonwealth Office

October 1980.



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10 DOWNING STREET

From the Private Secretary

27 October, 1980.

Dear Gange,

Development Policy

The Prime Minister has seen the Foreign and Commonwealth Secretary's minute of 20 October to the Chancellor of the Exchequer on this subject. She has commented that we must aim to concentrate on redistributing our aid from the multilateral sector to the bilateral sector. The Prime Minister does not consider that there can be any question of increasing our total effort.

I am sending copies of this letter to the Private Secretaries to the other members of OD and to David Wright (Cabinet Office).

Yours ever

Nihal Alexander

G.G.H. Walden, Esq.,
Foreign and Commonwealth Office.

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