1. The theoretical basis for using a weighted sum of the growth rates of income of different individuals (or income classes) as a better measure of welfare improvement than GNP growth was not fully examined in our draft note. In experimenting with different utility functions to provide this theoretical basis I come to the following conclusions:

(i) The basic proposition that a weighted sum of growth rates of individual incomes gives a better measure of welfare improvement than GNP growth rate is valid and can be derived from social utility functions.

(ii) Depending on the weights used, the weighted growth rate measures either the absolute increment or the rate of growth of social utility. Weighting schemes of the type proposed in our note must state which is being measured if they are to be correctly interpreted.

(iii) The implicit properties of the weights in our draft note are inconsistent with the utility function used by Atkinson. This function does yield weights to measure both absolute increment and the rate of growth but the weights have very different properties from ours.

(iv) The properties of our weights are only derivable from a semi-log utility function and then only if we are measuring increments to social welfare. This raises problems in using the weighted growth rates as performance measures, especially in cross-country comparisons.

These results are formally derived below treating each function in turn.

2. The general properties of the two functions discussed in this note are important in determining their a priori acceptability as social utility functions. Atkinson states that a social utility function should have two important properties. Firstly, it should be additively separable in individual incomes so that aggregate social utility is the sum of social utilities derived from individual incomes and each of these incomes is independent of incomes of other individuals. Secondly, it should be symmetric. In the case of an economy with individuals at different income levels, $Y_i$, this is written

$$W = U(Y_1) + U(Y_2) + \cdots + U(Y_j).$$

The particular function used by Atkinson satisfies this equation while the semi-log function satisfies the first condition but not the second, i.e. it is not symmetric. In this case the form of $U$ varies with individuals.

$$W = U_1(Y_1) + U_2(Y_2) + \cdots + U_j(Y_j).$$

Both functions satisfy the requirement that the marginal social utility of each individual's income is positive but diminishes with income.

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Separability (i.e. independence) is not philosophically desirable but it is necessary for tractable experimentation.
A. Constant Elasticity of Marginal Utility - CEMU: Atkinson

The particular form discussed by Atkinson is the familiar function with a constant elasticity of marginal utility (CEMU) with respect to incomes at all income levels.

\[ U = a + \frac{b}{1-n} y^{1-n} \]  for \( n \neq 0 \).

\[ U = \log Y \]  for \( n = 1 \) (more generally \( U = a + b \log Y \)).

This form is extensively discussed in the literature on optimum growth and more recently on project analysis. It is used in the draft Annex recently prepared by Messrs. van der Tak and Squires and its implications for estimating distribution weights in project analysis are discussed in my memo (attached).

4. The CEMU function provides a utility basis for interpreting weighted growth rates either as a measure of the absolute increment in welfare or the rate of growth of welfare. It is easily seen that the weights in each case are different.

(i) Absolute Increment in \( W \)

5. Differentiating Eq. (1) above using the form of \( U \) given in (2) we obtain the increment in welfare as a weighted sum of growth rates of \( Y_i \).

\[ dW = \sum \frac{\partial W}{\partial Y_i} \cdot dY_i = \sum b Y_i^{1-n} \cdot dY_i. \]

\[ = \sum b Y_i^{1-n} \cdot \frac{dY_i}{Y_i} = \sum \beta_i \frac{dY_i}{Y_i} \quad \text{where} \quad \beta_i = b Y_i^{1-n}. \]

Eq. (3) gives us weights \( \beta_i \) which depend upon income levels \( Y_i \) and the parameters \( n \) and \( b \). In fact the parameter \( b \) is unnecessary if we wish to measure utility increments up to a factor of proportionality given by the constant \( b \).

In this case

\[ \frac{dW}{b} = \sum \frac{Y_i^{1-n} \cdot \frac{dY_i}{Y_i}}{Y_i} = \sum \beta_i^* \cdot \frac{dY_i}{Y_i} \quad \text{where} \quad \beta_i^* = Y_i^{1-n} = \beta_i b. \]

For a given country we can compare the increment in social utility from two different growth patterns occurring at time \( t \) and \( t+x \) as follows. We compute a weighted growth rate at \( t \) by applying the weights \( Y_i^{1-n} \) to the growth rates of income of each individual at time \( t \). This gives \( \frac{dW}{b} \cdot b \). Comparing this with \( \frac{dW}{b} \cdot b \) similarly computed we can state which GNP growth produced a greater increment in \( W \).
(ii) Rate of Growth of W

6. An alternative interpretation of weighted growth rates is obtained by dividing through Eq. (3) by W giving

$$\frac{dW}{W} = \frac{1}{W} \sum b Y_i^n \frac{dY_i}{Y_i} = \frac{\sum \xi_i \frac{dY_i}{Y_i}}{\sum \xi_i}$$

where $$\xi_i = \frac{b Y_i^n}{W}$$.

Eq. (4) gives us weights $$\xi_i$$ which can be applied to the growth rates of individual incomes $$Y_i$$ to give a rate of growth of utility. Note that obtaining such a rate of growth of utility requires knowledge of $$W$$ for which we need all parameters of the utility function $$a$$, $$b$$ and $$n$$. This is more restrictive than simply measuring utility of increments.

7. The weights derived above have the following properties. These properties differ substantially from the implicit properties of the weights used in our weighting scheme.

(i) Neither of the weights discussed above will sum to a constant which can then be normalised to unity. [The only exception is the special case when $$a=0$$, $$b=1$$ and $$n=0$$. For these values $$U(Y_i) = Y_i$$ which is the implicit assumption in the traditional approach that total utility is measured by total income, viz. $$W = \sum Y_i$$. In this case $$\beta Y_i = Y_i$$ and $$\alpha_i = \frac{Y_i}{W}$$ which gives $$\sum \alpha_i = 1$$. This is not only an extreme case but an uninteresting one since the parameter reflecting egalitarianism is set at 0.] In general the sum of weights is a variable depending upon the levels of $$Y_i$$. This implies that the weights cannot be normalised to unity, and the sum of weights will vary with countries.

(ii) The elasticity of the weights (both $$\beta Y_i$$ and $$\alpha_i$$) with respect to income is $$(1-n)$$ which is less than unity for all $$n>0$$. In the traditional case (where GNP growth measures utility growth and $$\alpha_i Y_i$$), the weight $$\alpha_i Y_i$$ has unit elasticity to income. Once we allow egalitarianism ($$n=0$$) the elasticity $$(1-n)$$ is less than unity and the weight on growth rates of higher income classes rises less than proportionally for income. If $$n>1$$ then the elasticity is negative, which is obviously analogous to poverty weights in our weighting scheme.

8. Property (ii) above highlights the relationship between the parameter $$n$$ and "poverty weights" as defined in our note while property (i) shows up the difference. The parameter $$n$$ can be varied to approximate the effect of poverty weights, i.e. giving relatively less weight to the higher income classes. For all $$0<n<1$$ the weights on higher income individuals will be higher than for lower income individuals but less than proportional to income. For $$n>1$$ the weights will be actually lower which is what we called "poverty weights". I call this an approximation because the sum of weights in comparing two differ-

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1/ The usefulness of the CEMU function in project analysis and optimal growth derives from the fact that in considering ratios of incremental changes the only parameter that is relevant is $$n$$. 
ent growth situations will be different because the $Y_i$ will be different. This is not the case in our note and the difference is obviously critical for any numerical comparison.

9. When $n=1$ the CEMU function takes the form given in (2'). This is a special case of the semi-log function which is discussed below.

The Semi-Log Function

10. The semi-log function (which we discussed when first considering the weighting scheme) also provides a basis for a utility interpretation of a weighted sum of growth rates of individual incomes. The function is written

\[ W = \beta_1 \log Y_1 + \beta_2 \log Y_2 + \cdots + \beta_j \log Y_j. \]

This function shares several desirable properties with the CEMU function. Marginal social utility of income for each individual declines with income but is positive throughout. The function also has the property of additive separability. Unlike the CEMU function it is not symmetric - the form of $U$ is not the same for all individuals since $\beta_j$ vary. In effect egalitarianism in this function is reflected firstly in the log transformation which gives diminishing marginal social utility of income for each individual and secondly in the $\beta_j$ parameters which vary with income levels and we can assume are higher for lower income groups.

11. As in the other case the semi-log function provides two types of weights. Differentiating Eq. (5) we have

\[ dW = \beta_1 \frac{dY_1}{Y_1} + \beta_2 \frac{dY_2}{Y_2} + \cdots + \beta_j \frac{dY_j}{Y_j}. \]

Dividing through by $W$ gives

\[ \frac{dW}{W} = \frac{1}{W} \cdot \frac{dY_1}{Y_1} + \cdots + \frac{\beta_j}{W} \cdot \frac{dY_j}{Y_j}. \]

Both Eq. (6) and (7) provide a theoretical basis for interpreting weighted growth rates as alternative measures of improvement in social welfare and the weights in each case are different. The properties of the weights obtained are listed below.

1/ In the CEMU function egalitarianism is entirely due to diminishing marginal social utility with no loss of symmetry. The desire for symmetry is philosophically important. Note that symmetry implies that social welfare maximization subject to total income constraint requires that income be distributed equally. A non-symmetric function will not yield income equality as a necessary condition for a social welfare maximum.
12. The weights derived from the semi-log function have the following properties

(i) To obtain weighted growth rates which measure rate of growth of utility we need to know $W$ in constructing the weights. The weights $β_i^*$ on the growth rate of income of individual $i$ will vary with $W$. Since $W$ will vary over time and across countries, this is inconsistent with our scheme.

(ii) If we restrict ourselves to measuring the increment in social utility the weights $β_i^*$ on the growth rate of each individual's income are constant no matter how income levels change. This is different from the CEMU function where the corresponding weight would depend on the parameter $λ$ and upon income $Y_i$ (see Eq. 3). This property enables us to normalize the weights $β_i^*$ derived from the semi-log function to unity by dividing through by $\sum \beta_i^* = k$. This gives

\[
\frac{dW}{k} = \beta_1^* \frac{dY_1}{Y_1} + \ldots + \beta_j^* \frac{dY_j}{Y_j}
\]

where $\beta_1^* = \frac{\beta_1}{k}$.

Our weighting scheme for poverty weights is formally identical to this case which gives constant weights, $β_i^*$ for the growth rate of income of each individual $i$ independent of the total income or its distribution.

(iii) In the special case when all $β_i = b$ the semi-log function becomes symmetric and takes the same form as the CEMU function special case when $n = 1$. In this case both functions give weights which sum up to a constant and are the same for each individual. It is easily seen that this is identical to our egalitarian weights case. Suppose we have $n_i$ identical individuals at each income level $Y_i$, and total population equals $n_i = N$ (this notation has not been used throughout the memorandum for simplicity but it is obviously applicable). The social utility function is

\[
W = n_1 \cdot β_1 \log Y_1 + n_2 \cdot β_2 \log Y_2 + \ldots + n_j \cdot β_j \log Y_j + \ldots \quad \text{all } β_j = b
\]

Dividing through by $bN$ we can write Eq. 7

\[
\frac{dW}{bn} = n_1 \frac{dY_1}{Y_1} + n_2 \frac{dY_2}{Y_2} + \ldots + n_j \frac{dY_j}{Y_j}
\]

This is precisely the weighting scheme we termed as "egalitarian" where each income group growth rate was weighted according to the population share. (Note that this scheme in effect measures per
capita increment in social utility \( \frac{dW}{W} \) up to a factor of proportionality given by \( b \). This interpretation is not possible for the usual poverty weights case since the sum of weights is \( \sum f_i P_i \).

I conclude from the above that the properties of our weights were such that they cannot both be derived from the GEMU function although they can both be derived from the semi-log function. Both poverty weights and egalitarian weights as used by us are derivable only as measures of absolute increments of welfare and not rates of growth. Egalitarian weights can be derived from the GEMU function but only in a special case in which it is identical to the semi-log function. Furthermore, egalitarian weights represent only a particular parametric restriction on the utility function and not something special or qualitatively different from poverty weights. In the semi-log function they result from a restriction which limits egalitarianism entirely to the diminishing marginal utility of income as income increases. (Since all \( = b \) inter-individual differences in are not contributing to egalitarianism). In the GEMU function they result from \( n = 1 \) - again a parametric restriction.

C. Application of Weighting Schemes

14. How do the conclusions derived above affect the usefulness of the weighting scheme proposed in our note? This raises several questions which were not touched upon in the note itself or in discussions with Messrs. Stern, Haq and Kuczynsky. I suspect that even if we had data on the growth of income of different groups the specific weighting scheme proposed in our note needs to be used with great caution. I am particularly concerned about two problems arising out of two likely applications of the weighting scheme.

(i) Comparing Weighted Growth Rates Across Countries

If we are measuring only increments we must attempt to allow for the base level of \( W \) before comparing performance between countries. Interestingly this is less of a problem with "egalitarian weights" since if the utility function has the form necessary for egalitarian weights the weighted growth rate measures per capita increment in utility which removes size of population as a factor affecting \( W \) but still does not tackle the problem of different per capita income levels.

(ii) Comparing Weighted Rate with Actual Rate

The other most likely use of the weighting scheme is to compare the weighted rate of growth with the actual rate of GNP growth for the same country. (The tendency will be to assume that if the weighted rate is lower then performance is bad). In effect what this comparison gives us is the utility increment from the actual distributional pattern of growth compared to the utility increment of the same growth rate occurring at all deciles, i.e. constancy of shares. As you know, Mahbub was worried about precisely this point. Since there is no reason to suppose that constancy of shares is in any sense a desirable performance level to be applied in all cases we should obviously not rank countries according to deviation from this norm.
17. This suggests a legitimate use of the weighting scheme proposed in our note. We can use it to compare the utility increment from a given growth pattern against the utility increment from any other growth pattern. Given that distributional objectives imply productivity trade-offs, altering the distributional pattern of growth will affect the overall level of GNP growth. The weighting scheme enables us to compare the two outcomes in terms of the utility increment from the growth which is obviously the relevant consideration. It is this rather than cross-country comparison of weighted rates or deviations of weighted rates from actual rates that the weighting scheme should be used for.
Distribution Weights, Utility Functions and Project Analysis

1. Let me say at the very beginning how much I enjoyed reading your Annex. I was particularly impressed by the attempt to produce a document that would serve as a manual while at the same time dealing explicitly with the analytical basis of the various "shadow price" derivations. I hope this flavour will survive all future revisions and amendments. The following comments are restricted to the section on Income Distribution.

2. Unlike other subjects covered, the subject of income distribution weights has not been extensively treated (at least not formally) in the literature and I feel the Annex should more fully explore the rationale of the utility framework underlying distribution weights. Some of what I say below is only stylistically different from your treatment but there is also a substantive difference on the question of whether distribution weights vary over time.

The Approach to Distribution Weights

3. We should distinguish between the general approach to distribution weights (methodology) and the specific formula for these weights. The basic problem is to weight increments of consumption accruing at different consumption levels to obtain a "utility based" measure of the total consumption increment due to the project. The weight $w_i$ to be given to an increment of consumption at any particular per capita consumption level $C_i$ (i.e. to an individual belonging to consumption class $C_i$) compared to the same increment at some numeraire level $C_s$ is the ratio of social utility of an increment of consumption at $C_i$ to the social utility of an increment of consumption at $C_s$. This enables us to aggregate consumption increments occurring at different consumption levels into a utility equivalent increment at the numeraire level $C_s$.

4. You handle this problem by assuming a welfare function which is symmetric and additively separable in individual consumption. This is a general restriction on the form of the utility function implied by your methodology. For an economy with $J$ individuals (or consumption classes) at $J$ different consumption levels $C_1 \ldots C_J$ the utility function is of the form:

$$W = U(C_1) + U(C_2) + \ldots + U(C_J).$$

This has the property that $\frac{\partial W}{\partial C_s}$ is independent of $C_s$ for $s \neq i$, which is important for your results. ($U$ is the same for all individuals giving symmetry.)

5. Given this utility framework the weight $v_i$ for an individual at consumption level $C_i$ using the consumption level of the $s^{th}$ individual (or class) is simply:

$$v_i = \frac{U(C_s)}{U(C_i)}$$

More generally this can be written as $W = \int U(c) f(c) dc$. 

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This is, of course, relevant only for infinitesimal changes in consumption whereas you are concerned with non-marginal changes from a level $C_1$ to a level $C_2$. In this case the ratio becomes

\[
(3) \quad d = \frac{U(C_2) - U(C_1)}{U(C_s + C_2 - C_1) - U(C_s)}
\]

In your notation $C_s$ would be written $\bar{C}$ since you use average level of per capita consumption as the "numeraire level". (Equation 3 is similar to your own equation on page 33 except for the fact that your denominator term is $(C_2 - C_1) . U'(C_s)$. This is incorrect, as pointed out by Mr. Anand and I assume you accept the correction. Note that in Equation 3 above the numerator and denominator measure increments of utility symmetrically, which is not the case in your formulation.)

The Formula for Distribution Weights

6. The above approach is perfectly general given only that the social utility function has the properties specified. Your specific results are derived from a particular utility function which has the property that the marginal utility of consumption $U'(C)$ has a constant elasticity with respect to $C$ for all levels of consumption (for which function may the Lord make us truly grateful!). This function is written

\[
U = a + b \ln C^{1-n} \quad \text{for all } n \neq 1.
\]

From Eq. 2 we can write the distribution weight $d_1$

\[
d_1 = \frac{C_1^{1-n}}{C_s^{1-n}}.
\]

7. I think the Annex would benefit from a brief statement of the properties of these weights. If we stick to the formula for infinitesimal changes we can examine these properties in some detail with minimum algebra and notation. Particularly interesting in this context is to determine the time path of these weights since the derivation above refers to utility increments occurring at a particular point in time. Let us consider two types

1/ The function takes the form $U = \log y$ for $n=1$. I agree with S. Anand that your formulation showing different versions for $n>1$ and $n<1$ is unnecessary. When $n>1$ the constant $a$ is simply interpreted as bliss. $U \rightarrow b$ as $C \rightarrow \infty$ and $b \frac{1-n}{1-n} C^{1-n} \rightarrow 0$. 
of situations, one in which the distribution pattern is stable and the other when it changes over time. It can be shown that the Annex has only the former case in mind.

(i) Stable Distribution Patterns

8. We define stability in distribution patterns as a situation in which consumption shares of different individuals remain constant, i.e. consumption of all individuals grows at the same rate. In this case \( C_{1t} = \lambda C_{st} \) for all \( t \) where the \( t \) subscript indicates time. This means consumption of individual 1 is a constant proportion \( \lambda \) of the consumption level \( C_s \) (which may be interpreted either as the consumption of a particular individual chosen as numeraire or as a numeraire level) over the relevant time horizon. The distribution weight \( d_{1t} \) is easily seen to be constant over time.

\[
d_{1t} = \frac{c_{1t}^{-n}}{c_{st}^{-n}} = \frac{(\lambda C_s)^{-n}}{C_s^{-n}} = \lambda^{-n}.
\]

Equation (4) shows (by observation) the various properties of the distribution weight. The weight is determined by the proportional relationship between \( C_1 \) and \( C_s \) and the parameter \( n \). The following properties are obvious from observation.

(a) The weight on consumption increments accruing at \( C_1 \) equals unity if \( n=0 \). This is the typical bank assumption which implies a utility function where \( U = a + bC \) and \( U'(C) = b \). This implies that \( \frac{U'(C_1)}{U'(C_s)} = 1 \) for any \( i \) and \( s \).

(b) For any greater degree of egalitarianism where marginal utility declines with consumption \( n>0 \) in which case we have the following properties:

\[
d_{1t} > 1 \quad \text{if } \lambda < 1 \quad \text{and also } d_{1t} \text{ increases as } n \text{ increases; } 1/
\]

\[
d_{1t} < 1 \quad \text{if } \lambda > 1 \quad \text{and } d_{1t} \text{ decreases as } n \text{ increases.}
\]

(c) For given \( n>0 \), the weight depends only on the proportionality factor and is independent of the level of \( C_s \). This is called constant (relative) inequality aversion. Alternatively we might have increasing (relative) inequality aversion where weight rises with \( C_s \) for given \( \lambda \). 2/

1/ Differentiating (4) above:

\[
\frac{d_{1t}}{d_{1t}} = \lambda^{-n} \quad \text{and } \frac{d_{1t}}{d_{1t}} = \frac{\lambda^{-1}}{n} \quad \text{for } \lambda > 1
\]

2/ See Atkinson "On the Measurement of Inequality", Journal of Economic Theory, 1970. Atkinson points out we may be more concerned with inequality as incomes rise we have increasing (relative) inequality aversion.
Spelling out these properties in terms of Equation 4 would help focus on the analytical issues and provide a basis for extending the framework as suggested below.

(ii) Changing Distribution Patterns

9. Suppose that the pattern of distribution is changing over time, i.e., consumption of different individuals grows at different rates. This is obviously a highly realistic possibility given the experience of various countries. It is also important because it implies that the time path of distribution weights may be different for different consumption classes. The distribution weight $d_{lt}$ converting increments of consumption to consumption class $C_{lt}$ (in each period) into iso-utility increments at some numeraire class $C_{st}$ (in the same period) can still be written as follows:

$$d_{lt} = \frac{c_{lt}}{c_{st}} \cdot \frac{c_{lt}^{-n}}{c_{st}^{-n}}$$

But $d_{lt}$ will now vary over time as $C_{lt}$ and $C_{st}$ vary.

10. Suppose that the growth characteristics of the economy are such the consumption of an individual in class $C_{lt}$ grows over time at rate $\alpha$ while consumption level of an individual in the numeraire class $C_{st}$ grows at rate $\beta$. If the initial position (at $t=0$) is $C_{10} = \lambda_0 C_{S0}$ we can write $C_{lt} = (\lambda_0 C_{S0}) e^{\alpha t}$ and $C_{st} = C_{S0} e^{\beta t}$. In that case the time path of the distribution weight is given by:

$$d_{lt} = \frac{c_{lt}^{-n}}{c_{st}^{-n}} = \frac{(c_{S0} e^{\alpha t})^{-n}}{(c_{S0} e^{\beta t})^{-n}} = \lambda_0^{-n} (\beta - \alpha) t n$$

Note that the distribution weight is identical to the stable distribution case at $t=0$ but changes over time if $\beta - \alpha \neq 0$. In the stable distribution case $\beta = \alpha$ so that $(\beta - \alpha) = 0$ and the exponential term $= 1$ for all $t$. The time path for $d_{lt}$ has the following properties:

- For $\lambda < 0$: The weight $d_{lt} > 1$ at $t=0$. It increases over time if $\beta > \alpha$ (distribution worsens) and decreases if $\beta < \alpha$ (distribution improves).

- For $\lambda > 1$: The weight $d_{lt} < 1$ at $t=0$. It increases over time if $\beta > \alpha$ (in this case distribution is improving since $C_{lt} < C_{st}$ and the weight given to increments at $C_{lt}$ is increasing from less than unity towards unity. Symmetrically the weight decreases if $\beta < \alpha$ in which case distribution is worsening.
11. These results are a logical extension of the stable distribution case. They are not discussed in the Annex but as you can see they can be easily incorporated into a simple framework dealing with infinitesimal changes in consumption occurring at different consumption levels. The results also hold in the case of discrete changes in which case using Eq. 3 we can substitute for \( C_2 \) and \( C_1 \) in the formula and obtain \( q_1 \) as a function of various proportionality factors and the parameter \( n \).

**Intertemporal Discounting and Distribution Weights**

12. The above scheme also permits a clear identification of the relationship between intertemporal discounting of consumption and interpersonal aggregation of consumption increments. As you point out, the rationale for intertemporal discounting of consumption is based on one or both of two factors:

(i) Pure time preference.

(ii) The fact that consumption increments occurring at different points in time imply different utility increments since the marginal social utility of additional consumption diminishes as consumption increases.

Project analysis has generally concentrated on the latter. The derivation of inter-temporal weights is analogous to the case of distribution weights. Social utility at time \( t \) is a function of the level of consumption at time \( t \), (or per capita consumption if we want to allow for population growth). The weight \( q_t \) on incremental consumption accruing in year \( t \) to reduce it to iso-utility present consumption is:

\[
q_t = \frac{U'(C_t)}{U'(C_0)}
\]

The usual formula for \( q_t \) is based on the familiar utility function \( U_t = a + b \sum_{t=1}^{T} C_t^{1-n} \). If consumption grows at the rate \( r \) we can write:

\[
q_t = \frac{C_t^{-n}}{C_0^{-n}} = \left(\frac{C_0}{C_t}\right)^{-n} = e^{-nr}.
\]

The present value of an increment of consumption at \( t \) is obtained by discounting (continuously) at the rate \( nr \). This is the familiar result that the consumption rate of interest = (rate of growth of consumption) x (elasticity parameter).

13. In your Annex you point to the parameter \( n \) as a common factor in both intertemporal discounting and interpersonal aggregation. This relationship is inevitable given the use of a common utility function which is additively separable in incomes accruing to different individuals and at different points in time. The assumption is sometimes questioned (as in Bela Balassa's memo) but some of the intuitive doubts can be resolved by examining the properties of distribution weight over time.
11. The time path of distribution weights (paragraph 9) can be used to illustrate the relationship between interpersonal and intertemporal aggregation. Let us take as the numeraire level of consumption a fixed level C* in the base year instead of consumption of a class or individual which is growing over time. Suppose that consumption of individual i is a proportion of this base year numeraire level and grows at the rate C. The time path of the distribution weight is

\[ d_{it} = \frac{U'(C_i)}{U'(C*)} = \frac{c^{-n}}{c^{*-n}} = \frac{(AC^n e^{at})^{-n}}{c^{*-n}} = \lambda^{-n} e^{nat} \]

This gives us a time path of a distribution weight \( d_{it} \) which converts consumption increments to individual i over time into iso-utility increments to consumption at base year level C*. Note that the term \( \lambda^{-n} e^{nat} \) reduces (in an intuitively plausible fashion) into a term \( \lambda^{-n} \) reflecting distribution weights and a term \( a e^{-nat} \) reflecting the consumption rate of interest for the consumption class i.

15. In your Annex you use the consumption rate of interest at various places. It is theoretically important to recognize that there is no single consumption rate of interest in an economy when consumption of different classes grows at different rates. By using a moving numeraire (i.e. C*) which grows at rate \( \alpha \) or \( \delta \), which grows at the rate of growth of consumption we avoid this problem by converting increments accruing to different consumption levels into increments accruing at the level C and then use the CRI relevant for C. This is formally correct only if we allow the distribution weights to vary over time. In this case inter-class differences in the rate of growth (the main ingredient into CRI given n) is reflected in the time path of distribution weights. The fact that you use the mean level of consumption instead of a consumption levels of a particular numeraire individual does not matter as long as different individual's consumption grows at different rates over time.

The Importance of Changing Distribution Patterns

16. Is this consideration important? I leave that for you to judge. Let me, however, point to an intriguing aspect of the problem. In your framework egalitarianism can be increased by raising the value of n. For any given growth rate in mean consumption C this means raising the consumption rate of interest. Does this mean that we must discount very highly consumption gains occurring at distant points in time? This is to some extent the problem that worries those who doubt the validity of using the same value of n for interpersonal an intertemporal aggregation. In my framework, if the consumption of the "poor" is not predicted to grow very fast (irrespective of mean consumption) then the consumption rate of interest on their consumption is not high. Using the CRI relevant for mean consumption is only justified if distribution weights vary over time to reflect the difference in rates of growth at different levels. In this case the changing distrin-
bution weights take care of what would otherwise be dealt with by different values of $n$. All of this assumes that your original assumption of additive separability and symmetry can be applied not only for interpersonal aggregation. Some of Bela's reservations relate to this assumption but I leave the discussion thereof to some future date.

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NEWS SUMMARY

UNITED NATIONS: Delegates to the Special Economic Session of the U.N. General Assembly unanimously approved today a series of detailed measures designed to give the developing countries a bigger share of world wealth. But a U.S. delegate, Jacob Myerson, told members, meeting as a committee of the whole assembly, that Washington did not accept any implication that the world now was embarked on "Something called a new international economic order." The 138-nation committee, headed by Dutch Development Minister Jan Pronk, called for concerted efforts to improve the terms of trade of developing countries in order to eliminate the economic imbalance between them and the developed nations.

PARIS: France has initiated a new drive to solve major economic problems dividing the industrial and developing nations, by inviting them to a resumed dialogue in Paris on October 13. President Valery Giscard d'Estaing sent the invitations yesterday to the ten delegations which pioneered the consumer-producer talks, which broke down in Paris last April. The U.S. quickly accepted the invitation, supporting France's contention that a broad consensus exists for renewing a dialogue on energy, raw materials and other Third World development problems. French Foreign Minister Jean Sauvanarouges said the move to relaunch the consumer-producer talks should not be seen as a maneuver against the Organisation of Oil-Exporting Countries (OPEC), which is now planning an oil price increase.

PORT LOUIS: Britain has granted Mauritius a five million sterling loan to help finance the country's Five-Year Plan up to 1980, Finance Minister Sir Veerasamy Ringadoo said in Port Louis. The Minister also announced a loan of one million sterling from the European Investment Bank for developing the electricity service. Returning after a mission from the U.S. and Europe, Sir Veerasamy said yesterday his government had begun negotiations with the World Bank to increase an agreed loan from five million to 7,500,000 dollars.

LAGOS: Nigeria's financial aid to developing countries in Africa and other parts of the world will henceforth be channelled through international organizations, the Federal Commissioner for Foreign Affairs Colonel Joseph Garba, said in Lagos. Colonel Garba said previous direct aid by the ousted government of General Yakubu Gowon, had been made so as to build an international image around personalities.

COLOMBO: Sri Lanka's former Finance Minister, Dr. N.M. Perera, said Monday the administration is planning to devalue the Sri Lanka rupee under pressure from the World Bank and the IMF. Dr. Perera, whose Trotskyite Sama Samaia Party was expelled from the Government early this month, told a rally in Colombo on Friday his Party would oppose any devaluation, which would impose extra burdens on the people. He said he had reliable information that such a step was being considered by the Government under Prime Minister Mrs. Bandaranaike.
TOKYO: Japan Times, a leading English-language daily, today published a full-page article written exclusively for the paper by Mr. John Adler, Director of the Programming and Budgeting Department of the World Bank.

Mr. Adler said "In virtually all important industrial countries of the world, including the U.S., Japan and Germany, the turning point in the cyclical outlook has been reached or passed...what remains uncertain are the speed at which recovery is taking place and the effectiveness of the policies which are being applied, the unprecedented combination of unemployment of men and industrial capacity on the one hand, and continued price increase on the other."

The World Bank Department Director said the immediate outlook of the first group depended on the rate at which the markets for their exports improved in line with the expansion of production in the industrialized countries.

As to the prospects of the world economy in the longer run -- toward and beyond the end of this decade -- Mr. Adler said they would be determined by the extent to which solutions can be found to four sets of issues.

These pertained to the cohesiveness of the social structure of market economies, the reconciliation of the objectives of continued growth and improvement in the quality of life, the relations between the rich and poor countries of the world in some system of a "New international economic order" and the prevalence of absolute poverty in the poorest countries and, to a lesser extent, in the middle income countries.

Touching on problems of the "oil shock" and the adverse effects on the world economy and the oil exporters' expenditures on goods and services imported from abroad, Mr. Adler said the swiftly-changing economic situations in the world had persuaded most of the industrialized countries to change the objective of their monetary and fiscal policies from one of constraint to one of expansion.

He said the situation was similar in most industrial countries: the downtrend had ended and an upturn was under way or in sight in the second half of 1975. But the recovery would be slow and uncertain.

"With a period of sluggish recovery and slow resumption of growth in the industrial countries ahead, and apprehension about a new flare-up of inflation lingering one, prospects for a renewal of the commodity boom are remote: and the likelihood of less than full employment reduces the prospects for a rapid expansion of export markets for industrial goods," he said.
Regarding the countries with a per capita income below US$200, Mr. Adler said it was difficult to look at their short-term prospects with equanimity.

Barring another round of natural disasters and political turmoil and assuming the flow of aid to them would continue and gradually increase, one could foresee at best a resumption of growth at rates somewhat above the completely unsatisfactory rates of the last few years, he said.

"The most disconcerting aspect of this somber outlook is its implication that a large part of the population of the low income countries -- for some 500 or 600 million people -- will continue to live in conditions of absolute poverty."

The English-language daily newspaper, Yomiuri, on Monday carried a news agency dispatch, datelined Manila, which said that the World Bank had assured Malaysia it would continue with loans for the Asian country's Third Five-Year Plan beginning next year. It was reporting a statement by Malaysian Deputy Finance Minister Chong Hong Nyan who was on his way back home from the IMF-World Bank Meetings in Washington.

The report quoted the Malaysian Minister as saying that the Bank's Vice President, Mr. J. Burke Knapp, had given the assurance because Malaysia had been a good client and held a good credit standing with the Bank.

The Minister told newsmen a senior official of the Bank would go to Kuala Lumpur by the end of this month to study projects to be carried out with the Bank's assistance, the report added.

LONDON: President Giscard D'Estaing's invitation to the oil producing and consuming nations to resume the stalled energy talks was reported in the Times and Financial Times newspapers today.

Reporting from Paris, the Financial Times correspondent said the statement issued by the Elysee Palace made it clear that the talks would still be in the form of a preparatory conference, as were last April's discussions which broke down.

According to the Financial Times correspondent, it was also clear that "Several of the fundamental problems" which led to the breakdown in April have already been settled.

A Brussels datelined report in the Times said the EEC Foreign Ministers welcomed the French call and added they agreed to be represented at the talks to be resumed in Paris on October 13.
Stating that the French proposal to resume the energy talks had not been unexpected, the Times' Brussels correspondent added: "One reason for the urgency is that the OPEC countries will be holding a meeting of their own towards the end of the month to discuss possible price rises and it is considered desirable that they should have received their invitations to the preparatory consumer-producer talks before then."

The Times correspondent noted that the atmosphere for such talks was felt to have improved since the U.N. Special Session.

"The EEC Nine have not elaborated a broadly coordinated approach to the raw materials producers," the correspondent said.

The Financial Times today noted, in a report from New York, that the U.N. was moving towards a single resolution on world economic reform "that could include a broad consensus on the monetary questions that have several times brought the conference to the brink of breakdown."

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BONN: The Frankfurter Allgemeine Zeitung said the developing countries could consider it as a success that the industrialized nations promised to increase their aid by the end of this decade to 0.7% of their national product.

The Third World could also be pleased by their promise to open their markets not only to its raw materials but also to its half-finished and finished products.

Another positive result for the developing countries was the increased financial aid from the World Bank and the IMF, the Frankfurter Allgemeine Zeitung said.

TOKYO: The Japan Times today carried the second and last part of an article written for the English-language paper by Mr. John Adler, Director of the Programming and Budgeting Department of the World Bank.

Referring to the problem of absolute poverty in the developing countries, Mr. Adler suggested that it must be tackled by a reduction of development objectives, away from the simple goal of average per capita income growth toward a concentration of development efforts in those sectors where absolute poverty is concentrated, in the rural areas and to a lesser extent in the urban slums.

"...The real challenge to the leadership of the developing countries in the years ahead is not so much the set of objectives of the new international economic order, but the humanitarian aim of mitigating, and ultimately eradicating, absolute poverty. If they put stress on that goal it should not be difficult to mobilize the support of the industrial countries for it," Mr. Adler said.
U.S. Urges Fund To Protect Poor Against Price Dips

UNITED NATIONS, Sept. 16—The United States proposed today the establishment of a $10 billion fund to protect the world’s poor nations from the extreme fluctuations of world market prices of the raw materials they export.

This was part of a package of general agreements reached at 7 a.m. today after an all-night session that concluded 15 days of intense negotiation at the special session of the United Nations General Assembly devoted to the future of the economic relations between the world’s rich and poor nations.

The final resolution—a long, technical paragraph—seemed to mark a major change in tone in the previously deteriorating relations between the two economic blocs.

The resolution amounts to a set of guidelines to an agenda for perhaps 10 years worth of detailed international economic negotiations between the industrial nations of the West and the Third World.

In exchange for a striking new American willingness to consider the special problems of poor nations that often depend on one raw material for their prosperity, the developing nations agreed to drop previous demands that there should be what amounts to an international planned economy that ignores the workings of the laws of supply and demand.

This has most recently taken the form of a demand for “indexation”—the establishment of a “market basket” of Western industrial goods whose price rises would automatically trigger price increases for the raw materials that the Third World exports.

Both economic experts and poor nations that went far beyond anything that had ever been done before,” British Ambassador Ivor Richard said.

Both European and Third World diplomats credited the United States in particular with a new desire to come to terms with the Third World.

In return, the poor nations accepted the dilution of most of the radical principles they had put forward in demanding a “new international economic order”—a restructuring of global economic mechanisms under rigid controls designed to redistribute the world’s wealth from rich to poor.

Both sides implicitly agreed to achieve their goals through negotiated agreements, rather than threats of disruption.

The package, which the United States and other Western nations offered—and what the Third World settled for—was the patching up of the existing system to compensate the poor for the disadvantages they suffer under it.

Specifically, the West made concessions in agreeing to negotiate and sign individual commodity price agreements such as those for tin and copper, despite their continued reluctance in theory to interfere with the “free market” economy.

The major U.S. proposal was a $10 billion fund that would provide poor nations with loans or grants whenever their overall export earnings suffered an abrupt decline because of a drop in raw material prices.

To develop the poor nations further, the United States proposed a series of new international institutions that would encourage the flow of private capital to the poor nations. This approach is meant to supplant increased government aid from the West.

The United States pledged $200 million to a new fund to help poor nations develop the capacity to grow their own food. It also endorsed a code of conduct for the transfer of technology to the Third World.

The concessions by the poor nations came mostly on principles. But this means that today’s compromise will leave the rich nations free to pursue their capitalistic approach when the talks end there.

For example, the Third World settled for weak language on tariff preferences for their goods. Such preferences will be granted only “where feasible and appropriate,” and could involve unspecified reductions in tariffs, rather than complete removal.

The poor nations also dropped from today’s resolution demands for the regulation of multinational corporations and for the right to expropriate the assets of foreign corporations and pay compensation under their domestic laws.

Besides thwarting the poor nations’ goal of indexation, the West avoided any commitment to the “so-called” “integrated approach” to commodity agreements. This means that the poor nations cannot now insist on one large package deal for all commodities—a negotiation in which their collective leverage would be greater.

U.N. economic experts pointed to the absence of any concessions by the oil-producing nations in today’s resolution. Western proposals for a consumer-producer forum on each commodity, including oil, were omitted, as well as any specific reference to guarantees that consumers could obtain stable commodity supplies.

But Assistant Secretary of State Thomas O. Enders, who served as the chief American negotiator in the climactic days of the session, claimed that today’s package contained references to 28 of the proposals outlined in the major U.S. policy speech at the start of the assembly. “It was responsive to our needs as well as to the poor,” Enders said.

U.S. satisfaction, however, was not complete. Under an “agreement to disagree,” reached on the final day of talks, the United States entered reservations on three or four of the major issues in the resolution. Other Western governments also registered reservations, but of a far more limited nature.

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I.

To determine from time to time the trends in the world economy and to assess its prospects over the next few years is necessary, desirable—and risky. It is necessary because business decisions and, above all, decisions of governments are unavoidably based on some notion, however inarticulate and hazy, of the direction in which the economy of a country and the international economy are moving. It is desirable because it inevitably involves an assessment of forces at work at present and an appreciation of the lessons to be learned from the recent past; this in turn may lead to a better general understanding of the workings of the economy. And it is risky— for those who look ahead because their professional reputations are at stake; for those who make decisions on the basis of forecasts because they may lose the opportunity to make decisions if they turn out to be wrong; and for those who may suffer from the consequences of wrong decisions.

This is a good time to look ahead—not because the perspective is clear and forecasting therefore less risky, but because in the last few months a period of major and violent changes has come to an end and as a consequence the outlook has changed. But before reviewing the events of the recent past and outlining the impact of recent changes on the years ahead, it may be useful to summarize the analysis that follows.
In virtually all important industrial countries of the world, including the United States, Japan and Germany, the turning point in the cyclical outlook has been reached or passed: the downward trend in production and employment which has characterized the last two years has been reversed in most countries and at least halted in all of them. At the same time, the rate of inflation, at an unprecedented high rate in 1974, has slowed down, though much less than one would expect on the basis of past experience in periods of slow business activity. There is no doubt that the slowing down in the world economy which occurred in 1974 was not the beginning of a prolonged deep depression—as some had feared—but only a serious recession, a severe cold but not a pneumonia of the vulnerable (but not so frail) system called The Industrial World. What remains uncertain are the speed at which recovery is taking place and the effectiveness of the policies which are being applied to the unprecedented combination of unemployment of men and industrial capacity on the one hand, and continued price increases on the other.

The last eighteen months have also shown the vulnerability and frailty of the economies of the developing countries. They have been buffeted by the falling off of demand for their major exports, accompanied by receding prices on the receipt side, and a sudden rise in the cost of their imports of fuels, foodstuffs and fertilizers, a slow but steady increase in the cost of all other purchases from abroad. The middle and higher income countries (those with a per capita income over $200) have managed to maintain the momentum of their development efforts only at the expense of a rapid increase in their foreign debts, while in the poor and least developed countries (with a per capita income of $200 or less) the growth of production and income has slowed down to a rate below that of population growth. The immediate outlook of the first group depends on the
rate at which the markets for their exports improve in line with the expansion of production in the industrialized countries; it is, to say the least, uncomfortable. In the case of the poor and least developed countries, even a quick (and unexpected) return in the industrialized countries to the buoyant conditions of 1972/73 will not bring much improvement; the resumption of per capita income growth will depend almost entirely on the size of the flow of foreign aid.

As to the prospects of the world economy in the longer run—toward and beyond the end of this decade—they will be determined by the extent to which solutions can be found to four sets of issues. They pertain to the cohesiveness of the social structure of the market economies; the reconciliation of the objectives of continued growth and improvement in the quality of life; the relations between the rich and poor countries of the world in some system of a New International Economic Order; and the prevalence of absolute poverty in the poorest countries and, to a lesser extent, in the middle income countries. These issues are not easy to solve. But since their solution does not entail a reduction in quality and quantity of living standards of any country or any social group they are politically feasible and amenable to a combination of intelligence and good will.

II.

The present conditions of the world economy have been shaped by a unique constellation of forces and events. In the early seventies the output of the world economy rose at a rate which could not be sustained, in the short run, by the growth of the industrial labor force, the supply of raw materials and the production of foodstuffs. As a result, wages and the prices of all other factors of production increased, slowly at first, but gaining momentum
as the price increases spilled from country to country and led to further increases in production cost. To make matters worse, production of food, always following an increase in demand with a time lag determined by natural conditions of production, declined as a result of adverse weather conditions—a combination of droughts and floods in a number of countries. On top of it came the oil crisis of late 1973 and early 1974: increases in the price of oil, initially combined with an embargo, resulted in a fourfold increase. The "oil shock" had a number of adverse effects on the world economy. The higher cost of energy accentuated the prevailing inflationary pressures; at the same time it caused many countries to take measures to protect their balance of payments by maintaining, or even raising, the rate of interest, in the face of the first signs that the peak of the boom had passed. The downturn itself was hastened by the falling off in the demand for automobiles. Perhaps more serious than these direct effects of the high price of oil were the indirect effects on the formulation of monetary and fiscal policies, which is always difficult at the turning point of a business cycle: it added immeasurably to the feeling of uncertainty and helplessness and thus caused delays in decision making which in themselves may have aggravated the situation.

In the event, one of the major preoccupations of the industrialized countries turned out to be greatly exaggerated: the very large balance of payments surpluses on current account of the major oil exporters, which rose from $6 billion in 1973 to $70 billion in 1974, while resulting in substantial increases in their foreign exchange holdings, did not over-burden the international monetary system. The flow of petro-dollars was absorbed without major discomfort, chiefly by the international banking system, with a small proportion going to the International Monetary Fund and to the World Bank. Moreover, the accumulation of foreign exchange balances of the OPEC countries in 1974 and in the first half of 1975 turned out to be much smaller than had been forecast—for two reasons. In the first place, the proceeds of oil exports were somewhat smaller than had been expected because the volume of oil imports of the major consuming countries were smaller. Secondly, the oil exporters' expenditures on goods and services imported from abroad increased much more than had been projected. The purchases of capital equipment and of
consumption goods and the prepayments on such purchases far exceeded expectations; moreover, in many countries incomprehensibly large amounts were used for the purchase of armaments, an allocation of resources hardly in line with economic and social priorities. Because of the high level of purchases from abroad, a number of OPEC countries, including Iran and some of the smaller Arab countries, have by now changed their roles in the capital and money markets of the world from net suppliers of funds to net borrowers; for some of them this appears to be a permanent change, for others it may be temporary only.

Thus, while the burden of high energy costs on the economies of the oil importing countries continues (and may even increase as a result of a further rise in the oil price), the psychological burden of worries about unprecedentedly large exchange holdings and their unpredictable effects on the movement of exchange balances and exchange rates has subsided. The changed outlook regarding the accumulation of OPEC reserves, and, as a corollary, the decline in the combined balance of payments deficits persuaded most of the industrialized countries in early 1975 that it had become less risky to change the objective of their monetary and fiscal policies from one of constraint to one of expansion. The main reason for the change was of course the growth in unemployment and the reduction in real GNP, especially in the United States and Germany. In the United States the decision to reverse policies was not easy since price increases continued, though at reduced rates, and there was the risk that inflationary pressures would be revived. So far this has not happened, largely because the reversal of policies came so late and the upswing has barely started. As a consequence, the consensus of the forecasts seems to be that inflation will slow down further through 1975 and into 1976,
while the gross national product will rise modestly. In Germany the scenario of the recovery is even less exciting. Until recently deficit financing by the Government failed to stimulate production because the uncertainty of the outlook caused consumers to reduce their expenditures and producers, with excess capacity at their disposal, saw no reason to increase their investment, although the supply of credit has become plentiful and cheap. There are now signs that the precautionary increase in private savings is coming to an end, but it will be some time until the economy has worked itself back to the trend line of steady growth at a high rate.

The situation is similar in most other industrial countries: the downward trend has ended and an upturn is under way, or in sight in the second half of 1975. But the recovery will be slow and uncertain—unless those optimistic observers of the American economy are right who see in the sharp increases in automobile sales in recent weeks the large reduction of business inventories and a more benign attitude of the monetary authorities than had been expected, unmistakable sign that the American economy is gaining momentum and may provide stimuli to the economies of its trading partners overseas. This presupposes, however, that price increases will not accelerate as unemployment is reduced and consumer purchases expand. It also presupposes that the effects of wage increases already negotiated or still to be negotiated will be offset by productivity gains associated with better capacity utilization. On balance, however, prospects are for a modest, not to say sluggish, recovery in the United States, Canada, Western Europe and Japan, and not a bouncing back to the conditions of rapid expansion which characterized the early seventies.
III.

That much for the short-term prospects of the industrial countries, who emerged scared rather than scarred from the oil crisis and the recession which it ushered in. The economic history of the last two years of the developing countries was substantially different, with worse results. The initial response of developing countries to the oil price increase covered the whole range of a frantic search for means of financing the growing balance of payments deficits to a resigned stance of helplessly doing nothing while exchange reserves, badly needed to pay for shortfalls of food, were drawn down to pay for oil imports. At the same time, the acute difficulties caused by their higher fuel bills notwithstanding, many countries were struck with awe by the success of the OPEC countries to combine their forces so effectively as to move, as it were, from rags to riches over night.

The burden of the high price of oil on the oil importing developing countries is getting worse. The increases in oil prices came at a time when many developing countries were at the crest of the cyclical wave of high prices of primary products. Since then, the price of major raw materials and foodstuffs have sharply declined—by an average of 27%, but with the prices of some commodities falling by as much as 60% (e.g. copper), or even more (e.g. coconut oil, copra, sugar). With the price of oil remaining four times as high as it was in 1973 and the prices of industrial products still going up, though at a slower rate than in 1974, the balance of payments deficits of the developing countries are still increasing, from $27 billion in 1974 to an estimated $36 billion in 1975. Development assistance is financing only a part of these deficits; approximately one-half of the 1974
deficit, and an estimated two-thirds of the 1975 deficit is covered by loans. A substantial proportion of them have short and medium-term maturities and thus add much to the debt service burdens of the next few years of those countries which suppliers of funds considered creditworthy. This mortgaging of future export earnings had, however, an important beneficial effect: it enabled the middle and higher income countries of the Third World to maintain a respectable rate of growth in 1974.

The situation is different in the poorest and least developed countries. Since the flow of private capital to them is negligible—simply because their prospects are such that they cannot be considered creditworthy—they have depended chiefly on public development assistance to finance their balance of payments deficit. Since a large proportion of the assistance was needed to meet the shortfall in food production, especially in the drought and flood afflicted countries of South Asia and the drought stricken areas of Africa, their imports needed to support their development efforts had to be sharply reduced, and their rate of growth of production was reduced below the rate of population growth. As a result, per capita income has decline, on average the population has become poorer, development has failed.

As to outlook for the rest of the decade, there is no assurance that things will get much better. The advancement of the middle and high income countries will depend to an appreciable extent on the export markets for their primary and industrial products. With a period of sluggish recovery and slow resumption of growth in the industrial countries ahead, and apprehension about a new flair-up of inflation lingering on, prospects for a renewal of the commodity boom are remote; and the likelihood of less then
full employment reduces the prospects for a rapid expansion of export markets for industrial goods. Moreover, the growth of short- and medium-term debts over the last few years reduces the possibilities of supplementing domestic resources through borrowings from abroad. Thus, the second half of the seventies is likely to be a period of slow growth—at a rate of, say, 5% a year compared with a rate close to 7% in the early seventies.

Regarding the countries with a per capita income below $200, it is difficult to look at their short-term prospects with equanimity. Even if one hopes that they will be spared another round of natural disasters and political turmoil (e.g. Bangladesh, Ethiopia) and assumes that the flow of aid to them will continue and gradually increase, one can foresee at best a resumption of growth at rates somewhat above the completely unsatisfactory rates of the last few years, but not a period of vigorous advancement implied in the general idea, and the targets, of the Second Development Decade.

The most disconcerting aspect of this sombre outlook is its implication that a large part of the population of the low income countries—for some 500 or 600 million people—will continue to live in conditions of absolute poverty; this subject is taken up once more below.
IV.

Turning now to the more distant future, the late seventies and the early eighties, one encounters several major problems and a general acknowledgement of their existence but no concerted attempts to find solutions. This is true both for those problems which have arisen in national settings and conceivably could be solved by national measures, and for those which require for their solution some form of international cooperation and consensus.

The difficulties of controlling inflationary pressures even in the face of widespread unemployment which has characterized most of the advanced market economies in recent years (and distinguishes them from the textbook models which treat inflation and unemployment as incompatible) is an economic aspect of the disturbance, not to say breakdown, of the structure of industrial society in which wages and prices are determined by competition and bargaining in the market place. The competing claims for higher wages, higher prices, higher social benefits reflect only in part dissatisfaction with the existing distribution of income among classes, regions, social groups and sectors; they stem also from dissatisfaction with the social order which bestows privileges and power and prestige on some and forces a dull life of hard work on others.

Because the ultimate causes of the dissatisfaction and of the ensuing disturbances of the economic system are not economic but social and psychological, it is difficult to conceive of economic policies which will once again strengthen the social cohesion of industrial societies. But the fact that no simple solutions are in sight does not mean that the problem will simply go away and can be ignored. It adds undoubtedly uncertainty to the outlook and the prospect of continued inflation and, as a consequence, of monetary instability.
The prospects of the next five to ten years are made even more uncertain by the questions which have been raised regarding the desirability of continued growth, in part because of the alleged threat of the exhaustion of physical resources—the "limits of growth" syndrome—and in part because of the conflict which it is claimed exists between continued material progress and the quality of life—the "quality of life" syndrome. The two sets of ideas complement each other: limitations on the availability of natural resources, including water and air, make it advisable to husband scarce resources so that their supplies will last longer; an economic system having unrestrained growth (of income and consumption) as its objective not only exhausts resources faster, but also detracts from the quality of life because it brings with it noise, pollution and deterioration of the environment. Again the world, or more specifically the industrial world, is faced with the economic effects of essentially noneconomic judgments such as the assertion that it is better to forego additions to material comfort in favor of more enjoyment of leisure—"meaningful leisure" is the standard phrase—and of the environment—the "unspoiled environment"--; or the statement that technological advancement can do little to reduce the depletion of resources and that therefore only a reduction in their present use will prevent, or at least postpone, the effects of the ultimate exhaustion.

It is unlikely that the industrial countries of the world, individually or collectively, will take a definite and unambiguous stand on these issues. But they will be taken into account in the formulation of economic policies and, incidentally, have a bearing on the direction of technological change and innovation.
There is of course general agreement that clean air and clean water, and unspoiled mountains and forests and beaches are preferable to polluted air and water and mountains, forests and beaches that have been spoiled and ravaged; but there is disagreement as to who is to bear the cost of making sure air and water are not polluted and mountains, forests and beaches are not spoiled. Similarly, there is consensus on the desirability of more leisure, but there is no evidence of willingness to forego income in return for shorter working hours.

There is no doubt that solutions on the issues regarding the distribution of the burden of measures to protect the environment and of more leisure and, one might add of improved social services can be found and accommodated in the framework of the political and economic institutions of the industrial countries. But they will further add to the constraints and complexities of the economic system along the same line as the social tensions referred to before: they will add to the difficulties of agreeing on a distribution of income acceptable as "just" and "reasonable" by all sectors and classes of the economy and thus add to the likelihood of continued inflationary pressures.

The third of the major issues facing the world economy in the years ahead is in essence an international corollary to the problems of the distribution of income within the developed economies. The manifest on the New International Economic Order presented by the developing countries to the United Nations General Assembly last May and adopted by a strong majority (with the developed countries, however, either voting against it or abstaining), in effect asserts that the present distribution of income among countries is no longer acceptable and must be changed. The Declaration
is explicit and articulate on the objectives of the New Order, but it has next to nothing to say as to the means by which the objectives are to be achieved. The Declaration contains references to the interrelationship between the prosperity of the developed and of the advancement of the developing countries, but the stance which the developing countries have taken so far is one of confrontation, not of cooperation. As a result, the Declaration has not led to discussions and negotiations and not even exploration whether common interests and common grounds for negotiations can be found.

Nevertheless, it appears desirable and feasible to find some common ground for arrangements which could benefit developing countries and industrialized countries alike. For example, the elimination of wide price fluctuations of primary commodities through the establishment of buffer stocks, financed and controlled both by producers and consumers, may bring long-term benefits to all parties. By the same token, the calls by proponents of the New International Economic Order for greater access of the industries of developing countries to the markets of industrialized countries is likely to bring benefits to exporting as well as importing countries because it would lead to a more rational international division of labor. Whether or not mutually satisfactory accommodations on these two issues can be reached depends almost entirely on the political will of the developing countries and of their leaders to replace the shrill voices of indignation and dissatisfaction with the muted sounds of negotiations and reconciliation.

It is a reflection of the political and emotional origin of the Economic Declaration of the New International Order that it does not deal with what
has recently become to be recognized as the most important problem of the
developing countries, the problem of absolute poverty which affects
primarily a large part of the population in the countries of South Asia--
India, Pakistan, Bangladesh, Sri Lanka, Nepal, Burma--and in Africa, but
also minorities of varying sizes in most countries of Latin America and
the Far East. The condition of absolute poverty prevails wherever people
income
live on a per capita/of, say, $50 or less, a year, and as a result are so
close to the margin of minimum requirements in terms of calories and the
composition of food intake that they are constantly threatened by famine,
epidemics and the effects of malnutrition on their physical and mental
capacity. Absolute poverty is nothing new; it probably has existed throughout
history. What is new is the recognition that in spite of the progress of
economic development of the last twenty-five years when the material welfare
of the average household in the developing countries has steadily advanced,
a substantial proportion of the population of the poorest and least
developed countries and a small but significant minority in many of the
middle income countries has been bypassed by the general advancement and
their condition of human misery continues. In some developing countries,
especially in those in which production and average income has increased at
a fast rate, absolute poverty can be mitigated and in time eliminated
through measures designed to redistribute income. But in most countries,
absolute poverty must be attacked by a redirection of development objectives,
away from the simple goal of average per capita income growth toward a
concentration of development efforts in those sectors where absolute poverty
is concentrated, in the rural areas and to a lesser extent in the urban slums.
Such a redirection calls not only for a concentration of capital expenditures (and foreign aid) in the poverty sectors, but also for current expenditures—on education, health, population control—and changes in economic institutions, such as land tenure and marketing arrangements in the rural sector, and improvements in social services, technical training and low-cost housing in urban areas. Thus, the real challenge to the leadership of the developing countries in the years ahead is not so much the set of objectives of the New International Economic Order, but the humanitarian aim of mitigating, and ultimately eradicating, absolute poverty. If they put stress on that goal it should not be difficult to mobilize the support of the industrial countries for it.

V.

This completes the tour d'horizon of the world economy in the near and medium term. One final remark may be in order. What the next ten years have in store, after the gradual recovery of production and growth now getting slowly under way, is a period beset with difficulties and uncertainties. In comparison with the period of the last twenty-five years, which covered the completion of postwar reconstruction as well as two decades of successful (and peaceful) growth, it appears full of new problems for which no easy solutions are in sight. There is, however, no reason for despair. The accomplishments of the last twenty-five years lend solid ground to the hope that the challenges of the next decade will be met.

John H. Adler*
August 18, 1975

*The views expressed in this paper are those of the author and not necessarily those of the International Bank for Reconstruction and Development.
The choice of the topic of my talk tonight is the outcome of a number of lectures which I gave in Japan at the beginning of last year. I had been asked to add a visiting fireman's voice to the chorus of professional forecasters, domestic and foreign, who engage regularly in the performance of economists' traditional rites, with lyrics which proclaimed that the recession was definitely over, just over, or almost over, and that inflation was slowly coming to an end, was definitely coming to an end, or was beginning to slow down.

I was encouraged by the response of those members of the audience who were pleased to hear what they had come to hear, but was getting somewhat bored by the discovery how easy it was to project the experience of the recent past into the near-term future. In consequence, I began to cut down my remarks on the short-term outlook and instead expanded my comments on the long-term trends and those forces and factors which are likely to shape them.

Since then, I have given some more thought to the issues which are with us today, some openly, and some barely discernible under the serene surface of a slow but steady global recovery. I have tried to ascertain the views of others but discovered soon to my discomfort that the descriptions and analyses of the issues besetting the world economy are completely fragmented. Virtually without exception their focus is so narrow that it is impossible to combine them into a coherent whole and to see the problems and the approaches to their solutions as parts of a complex pattern of interaction.
I must confess that it is not easy to do what I propose to do in the next half hour or so--because the distractions of the contemporary scene--of primaries in this country and of early pre-election maneuvers in Germany and in Japan, of the preparation of platforms, position papers, campaign speeches and other forms of "uncritical choices"--i.e. of words--are great and thoroughly enjoyable. But I suggest that a longer and broader view of the problems of the world economy is not only in the tradition of the almost forgotten science of political economy, but may also be more important and in due course may have more bearing on the political decisions which will have to be made--and their consequences--than campaign promises and campaign oratory.

Some of the issues which are likely to determine, in concert with others, the trend of the world economy over the next decade or so, have been with us for some time; others have emerged and given cause for concern only in the last year or two. I propose to single out, from a long list of candidates which prima facie deserve to be mentioned, just four. They are: one, the malfunctioning of the social structure of the advanced market economies of the world; two, the neo-Malthusian concern with the exhaustion of natural resources in the face of rapid population growth and, related to it, concern with the environment; three, the change in the compass of political confrontation from East-West to North-South; and, finally, the prevalence of what has become to be known as absolute poverty among, say, one-fifth of the world's population.

I mention the malfunction of the social structure of the advanced market economies first not because it is the weightiest problem besetting the world economy, but because it manifests itself right here in the country
and in more acute forms in Western Europe and even in Japan. It has been referred to, somewhat harshly, as the beginning of the breakdown of the social order of the capitalist system, or, in a phrase which had its origin in the Age of Enlightenment, as the repeal of the "contract social" of modern societies. Classical and neo-classical economic theories have no room in their view of things for the concentration of production in large organizations which because of their sheer size enjoy special advantages in the economic market place and in the political arena. [when I drafted these notes I became suddenly aware of the subtlety of common phraseology: the economic market place, orderly, business-like, amiable; and the image of the political arena, with violent action taking place in front of a loudly cheering but otherwise non-participating audience.]. Nor do they consider the countervailing economic and political forces of organized labor as "normal" and enhancing the functioning of the system. The normative classics looked at large corporations and strong unions as elements disturbing, and interfering with the smooth functioning of the system; and the neo-classical economists have not gone beyond a more sophisticated description of the concentration of economic and political power but have failed to recognize its effects on the efficiency of the system and, more importantly, on the cohesiveness of society. As countries and people have become more and more prosperous, thus proving the efficiency of competitive private enterprise, the individual groups—of workers, of businessmen, of corporations, of professionals—have discovered that, to paraphrase the Yale sociologist William Graham Sumner, social classes do not owe each other a blessed thing, and that conflict of interest is the rule, and not the invisible hand which somehow rearranges conflicting social forces in such a way that everything turns out for the best for everybody. [This, I promise, will
be my only—and only indirect—reference to the bicentennial of the publication of the Wealth of Nations, an occasion which in Oxford and Cambridge, and not to forget Glasgow, is considered much more memorable than the events which took place on the 4th of July 1776 in Philadelphia. Why then has the system of production and distribution become less efficient in the reconciliation of social conflict, class conflict if you will, and why has the force of predictable behavior—to avoid the term "economic law"—become so much weaker?

Joseph Schumpeter, the gentle iconoclast, suggested an answer to the first question and the answer to the second question is but a logical extension of the first. Private ownership of the means of production, controlled by "profit-hungry" innovating entrepreneurs has brought about rapid growth of material wellbeing, a fast rise in per capita income. It also has made it possible for a large part of personal income to be saved, not just for old age, or for the proverbial rainy day, but also for periods of discontent, strikes and lockouts; moreover, it has increased the value of leisure made possible by foregoing income, or by dissaving. These developments, common to all industrialized countries with a reasonable degree of political freedom, have greatly strengthened the power and the social and political acceptance of organized collective action. In those circumstances it is not surprising that the iron law of wages which was an essential part of the laws of political economy and proved, apparently to everybody's satisfaction, that any attempt to force wages above the level of labor productivity was futile, has been scrapped as an interesting piece of the history of economic doctrine but irrelevant for the present.
But the social and political consequences of the newly gained welfare of the working classes, low, middle and upper, are very much alive, as important forces in the current scene. To wit: strikes of public employees such as firemen, policemen, mailcarriers, school teachers, railroad workers, in this country, in Western Europe and even Japan, which would have met general disapproval a generation ago, have become regular seasonal occurrences; appeals by public authorities to multinational—or to use a new term which I heard just the other day—transnational corporations to stop exporting jobs as a consequence of investments abroad go unheeded, as do appeals to labor unions to consider the effects of their action on the public interest and the health of the national economy.

As an aside, it may be noted that these contemporary developments do not prove the failure of capitalism which Karl Marx had predicted as inevitable, but, to the contrary, they are indications of the success of the system, which makes it possible for workers to hold out for their demands, and for employers to continue policies and practices which are in their interest but not in that of the community.

The second result of the success of the economic systems of the Western industrial societies is a weakening of the mechanism of the price system. When individual and family incomes are higher, expenditures on any particular commodity and service constitute a smaller part of the total income and the response to price changes becomes weaker and slower. This change alone reduces price competition. The declining effectiveness of price competition is further reduced by product differentiation, real or apparent. The result is that monetary policies aiming at reducing, or stimulating, consumer expenditures,
are less effective than they would be if the sensitivity of the system to price changes were greater. This relatively new phenomenon in turn adds importance to the role of "pervasive" speculative movements; for example exchange rate adjustments designed to reduce imports and increase exports may induce speculation against the devalued currency because their expected effects are slow in coming.

The malfunctioning of the economic system has also had some non-economic side effects which in the long run may be more important than the difficulties caused by its success. It was only 10 or 15 years ago when the great majority in this country, and in Europe, held the strong conviction that whatever the defects of modern industrial society, government could cure them—through social legislation, controls against abuses of concentrated economic power, and gentle interventions in the bargaining process between employers and employees, and between consumers and producers. What happened to the Great Society on this side of the Atlantic and the Humanized System of Private Enterprise in Europe in which corporations were glad to shoulder, and live up to, their Social Responsibilities—all that with capitalized initials? Suspicion and dissatisfaction, reinforced by evidence of malpractices of financial incentives (in plain English: bribery and corruption), and of sheer technical and organizational incompetence, have taken the place of the Great Expectations of industrial peace and social justice.

Disillusionment has not been limited to a reassessment of the role of government in the social and political system, but has gone much beyond. It found its first and most violent expression in the radical student movements.
in the United States, in France, in Germany, in Japan. More recently, the incidence of the counter-cultures of the young and their impact on Western societies has declined. But it has left behind uneasy feelings of dissatisfaction and has led to a questioning of the relations between material progress and human welfare and satisfaction and searches, still uncertain and halting, for values which are to take the place of material and social success.

One form in which this dissatisfaction has found expression is the concern with the protection of the environment which in turn is closely related to the second problem which I have included in my list of major issues, the apparent incompatibility of unlimited material growth and limited natural resources.

It is still too early to tell to what extent the dissatisfaction with material success will affect the set of values which taken together make up Western culture. Some impact is likely because the skepticism with which the desirability of material success is regarded, is in the tradition of one of the dominant features of the culture, namely the high esteem in which austerity and frugality are held. The new emphasis on the virtues of doing without may do little more than reduce conspicuous consumption at the margin of jet-set and suburban high life; but it is also possible that its effect will be more profound and bring about changes in the pattern of consumption, consumer demand and, indirectly, production. It is rather amazing to observe the incongruity of seeing oil companies exhort their customers to buy less gasoline, utilities to plead for a more economic use of their output, cigarette manufacturers to advertise the harmfulness of their product, and consumer advisers in the pay of retailers suggesting to housewives to buy cheaper cuts of meat. One may be
suspicious of the sincerity of this display of love-thy-customer. But the fact remains that the effects of these efforts to reduce consumption, selectively or in the aggregate, is in the same direction as those of the advocates of conservation who take the finite availability of natural resources as their point of departure.

II.

From the perspective of the history of ideas the most interesting aspect of the discovery of the limits of growth, is that unlike most ideas they were not provoked by current events--as for instance the Great Depression triggered the whole body of thought of Keynesian economics--but emerged as it were out of nowhere as a prophecy of things to come but provable only in the abstract, not by current observations. True, the discovery of Meadows and associates, marketed and popularized in true entrepreneurial fashion by the Club of Rome, coincided with the growing awareness of the deterioration of the environment of industrialized societies in the form of water and air pollution, and with the discovery of the carcinogenic effects of some products of modern petrochemistry. But the warnings that industrial societies were faced with the prospects of the exhaustion of natural resources, including life-sustaining air and water coincided with the Green Revolution which was hailed as the solution--in the nick of time as it were--of the threat of pernicious famine, the negative check of the Reverend Malthus to uncontrolled, and uncontrollable, population growth among the poor nations of the world. And it was followed shortly by the discovery, in the wake of the oil embargo that the reserves of hydrocarbons were greater than the most optimistic forecasts had indicated. Similarly, the interruption of growth of
the industrial economies for not more than two years showed that at least for the present, but presumably for some time to come, the problem facing this generation and probably the next one and the one after that as well, was not scarcity of materials, but intermittent over-production.

This does not disprove the logic of the proposition and the prospects that some growing levels of consumption associated with population growth, even at a moderate rate, and growth in per capita income will some time in the future lead to the exhaustion of some resources; nor does it dispose of the impact of the concern with the environment and the supply of natural resources on the world economy.

As I said before, the economic prospects of industrial societies has become more uncertain by the lack of consensus on social and economic aims. They have been made even more uncertain by questions which have been raised regarding the desirability of continued growth, in part because of the alleged threat or the exhaustion of physical resources—the "limits of growth" syndrome—and in part because of the conflict which it is claimed exists between continued material progress and the quality of life—the "quality of life" syndrome. The two sets of ideas complement each other: limitations on the availability of natural resources, including water and air, make it advisable to husband scarce resources so that their supplies will last longer; an economic system having unrestrained growth (of income and consumption) as its objective not only exhausts resources faster, but also detracts from the quality of life because it brings with it noise, pollution and deterioration of the environment. The industrial world is faced with the economic effects of essentially non-economic judgments such as the assertion that it is better
to forego additions to material comfort in favor of the more enjoyment of leisure—"meaningful leisure" is the standard phrase—and of the environment—the "unspoiled environment"--; or the assertion that technological advancement can do little to reduce the depletion of resources and that therefore only a reduction in their present use will prevent, or at least postpone, the effects of the ultimate exhaustion.

It is unlikely that the industrial countries of the world, individually or collectively, will take a definite and unambiguous stand on these issues. But they will be taken into account in the formulation of economic policies and, incidentally, have a bearing on the direction of technological change and innovation.

There is of course general agreement that clean air and pure water, and unspoiled mountains and forests and beaches are preferable to polluted air and water and mountains, forests and beaches that have been spoiled and ravaged; but there is disagreement as to who is to bear the cost of making sure air and water are not polluted and mountains, forests and beaches are not spoiled. Similarly, there is consensus on the desirability of more leisure, but there is no evidence of willingness to forego income in return for shorter working hours.

There is no doubt that solutions on the issues regarding the distribution of the burden of measures to protect the environment and of more leisure can be found and accommodated in the framework of the political and economic institutions of the industrial countries. But the search for such an accommodation will further add to the difficulties of agreeing on a distribution of income (and of the cost of environment protection) acceptable as "just" and "reasonable" by all sectors and classes of the economy.
III.

The third of the major issues facing the world economy in the years ahead is in essence an international corollary to the problems of the distribution of income within the developed economies. The Declaration on the New International Economic Order presented by the developing countries to the United Nations General Assembly in May 1974 and adopted by consensus (with many developed countries, however, recording reservation on crucial parts), in effect asserts that the present distribution of income among countries is no longer acceptable and must be changed.

The Declaration is explicit and articulate on the objectives of the New Order, but it had next to nothing to say as to the means by which the objectives are to be achieved. The Declaration contains references to the interrelationship between the prosperity of the developed and of the advancement of the developing countries, but the stance which the developing countries took for the better part of last year was one of confrontation, not of cooperation. It took a major effort of the industrial countries, especially France, to start a dialogue which finally got under way at the North-South conference in Paris but so far has not gone beyond a hopeful exploration whether common interests and common grounds for negotiations can be found.

There are signs that the UNCTAD meeting convening in less than two weeks in Nairobi will mark a resumption of the strategy of confrontation, although a number of the rich countries have indicated willingness to consider—and ultimately make—concessions on trade and commodity prices and to reassert their commitments to expand their development aid.
It is obviously desirable and presumably feasible to find some common ground for arrangements which could benefit developing countries and industrialized countries alike. For example, the elimination of wide price fluctuations of primary commodities through the establishment of buffer stocks, financed and controlled both by producers and consumers, may bring long-term benefits to all parties. By the same token, the calls by proponents of the New International Economic Order for greater access of the industries of developing countries to the markets of industrialized countries are likely to bring benefits to importing as well as exporting countries because their implementation would lead to a more rational international division of labor. Moreover, the exploitation of hitherto undeveloped deposits of minerals could bring benefits both to developing and industrialized countries.

Whether or not mutually satisfactory accommodations on these issues can be reached depends largely on the political will of the developing countries and of their leaders to replace the shrill voices of indignation and dissatisfaction with the muted sounds of negotiations and reconciliation, and the extent to which the governments of the advanced countries can come to grips with their domestic problems.

The outcome of the search for mutual accommodations will also depend to some extent on the attitude of the Soviet Union and its satellites, and on the policies of the nouveaux riche oil export countries. As to the Soviet Union, one cannot but admire the skill, and the effectiveness, with which they have handled their response to the demands for the New International Economic Order. In an approach which must be considered low-keyed and aloof by the new standards of diplomatic discourtesy customary at international gatherings, they have conveyed their sympathies with the cause of the
developing countries as the victims of Colonial Imperialism, without ever mentioning the possibility that they themselves could make any more tangible contributions to alleviate the plight of the poor countries.

As to the OPEC countries, the first few months after the fourfold increase in oil prices (and oil revenues) were a period in which the solidarity of objectives of OPEC with those of the oil importing developing countries was expressed not only in an avalanche of words, but also by financial aid and promises of further aid. Since then, the prospects of OPEC to make significant contributions to bridge the gap between the Old and the New Economic Order have rapidly diminished because oil revenues turned out to be appreciably smaller than had been expected, but chiefly because a number of oil exporters found it easy to increase imports just as fast, or even faster, than export earnings. What was hoped to become a large accumulation of global savings, forced out of the incomes of the rich countries, evaporated, or, to be more exact, took the form of increased consumption, conspicuous or otherwise, and investment, some eminently desirable and some of doubtful social profitability, and much of it fell victim to the lures of armament peddlers.

Nevertheless, the OPEC countries gained and retained the friendship, not to say admiration, of the other developing countries. They accomplished this not because they proved their proclaimed solidarity with the poor countries by material help, but because they had managed to defy the economic and political interests of the "old" rich countries by forming a cartel which so far has been remarkably successful, the differences in the economic objectives and political structure of its members notwithstanding.
The forming of the alliance between the OPEC countries and the other developing countries, and the maintenance of a common front are the more remarkable since it has become clear in the last two years that the damage done by increased fuel costs to the developing countries and their growth ambitions is relatively much greater and more pernicious than the impact which the high cost of fuel has had on the economies of the rich countries. Much of the burden of higher fuel cost has been absorbed by the industrial countries, taken as a group; through increased exports at a time when there was excess capacity and much unemployment in the system. True, the "oil shock" was undoubtedly one of the causes of the recession in this country, in Western Europe and Japan, and in that sense the industrial countries paid dearly for the disappearance of cheap fuel. But the dire predictions that huge debts to the oil countries would threaten the very existence of the private enterprise system of the Western World, and that the world monetary system would be unable to handle the reserve accumulations of OPEC countries turned out to be greatly exaggerated—to say the least.

But the predictions regarding the problems of the world's poor unfortunately turned out to be correct. Their plight in the form of a combination of food shortages caused simply by bad weather, both in Asia and in Africa, and of a falling off of the demand of their exports and the prices of their major export commodities, was compounded by higher costs of fuel and petrochemicals, especially fertilizers, and the disturbance by the "oil crisis" of the flow of development aid. In the major countries of Asia, and in the drought stricken countries of Eastern and Western Africa development has stopped; and in a number of countries per capita income declined.
The situation is quite different in the middle income countries in Latin America and the Far East. Contrary to earlier predictions, their economies continued to grow although at a reduced pace. They managed to maintain their growth momentum by borrowing large amounts of money at short and medium maturities thereby aggravating their already serious debt problem. In preparation of the forthcoming UNCTAD meeting a number of them have advanced proposals for a debt reorganization whereby all commercial debts falling due over the next few years are to be refinanced over longer periods by a new international agency. One may sympathize with the objectives of these proposals, which would relieve in short order the balance of payments pressures of the debtor countries. But one must also realize that they are extremely dangerous in that they could seriously affect the perceived credit-worthiness of all developing countries for all kinds of loans and credits.

Thus the quest for a New International Economic Order has started under difficult circumstances. The demands of the poor countries--for stable prices of their exports, for unimpeded access to the markets of the rich countries, for debt relief, for a larger flow of aid, for a larger share in the world's industrial productions, and for a greater voice in the decision-making process of international bodies--have only one virtue: they cover comprehensively the divergent need and interests of all developing countries and thus offer something for everybody. But since they have been advanced entirely in political terms and justified by moral indignation, the prospects of their acceptance are slim, even as the opening gambit for a protracted period of negotiations. Thus even with the goodwill of many of the rich countries on the side of the developing countries, it appears that the New International Economic Order will be slow in coming. The best that can be hoped for is that dialogues of accommodations, disrupted ever so often by
the diatribes of confrontation, will be with us for a long time. This is, I should stress, an optimistic view, compared with that of Bertrand de Jouvenel, a French social philosopher, who said last week in Philadelphia at a meeting of the Club of Rome that the world was not evolving toward a new international order in which the advanced countries would make larger resources available to the poor countries. In his view, such a "historical change" could not come about without more turbulence and violence.

It is a reflection of the political and emotional origin of the Declaration of the New International Economic Order that it does not deal with what has recently become to be recognized as the most important problem of the developing countries, the problem of absolute poverty which affects primarily a large part of the population in countries of South Asia—India, Pakistan, Bangladesh, Sri Lanka, Nepal, Burma—and in Africa, but also minorities of varying sizes in most countries of Latin America and the Far East. The condition of absolute poverty prevails wherever people live on a per capita income of, say, $50 or less, a year, and as a result are so close to the margin of minimum requirements in terms of calories and the composition of food intake that they are constantly threatened by famine, epidemics and the effects of malnutrition on their physical and mental capacity. Absolute poverty is nothing new; it probably has existed throughout history. What is new is the recognition that in spite of the progress of economic development of the last twenty-five years when the material welfare of the average household in the developing countries has steadily advanced, a substantial proportion of the population of the poorest and least developed countries and a small but significant minority in many of the middle income countries has been bypassed by the general advancement and their condition of human misery continues.
The reasons for the failure of many countries to bring about what used to be called balanced growth of sectors and regions are not hard to find. Conventional wisdom has it that the prime determinant of the rate of economic advancement is the rate of capital formation, i.e. in the first instance the rate of savings. The normative consequence of this proposition is that economic policy must favor those who save and those organizations which manage to accumulate profits. That means that public policy must foster industrial development and support it by public investment for power, transportation, etc. and, if necessary, by protection. It must reward those few who have entrepreneurial talents and are willing to risk their own money in industrial ventures. Concentration of development efforts in the industrial, or more broadly the urban sector, inevitably leads to the neglect of the rural sector which by its sheer size is difficult to organize and where the simple prescription of the application of capital does not seem to work.

In some developing countries, especially in those in which production and average income have increased at a fast rate, absolute poverty can be mitigated and in time eliminated through measures designed to redistribute income. But in most countries absolute poverty must be attached by a redirection of development objectives, away from the simple goal of average per capita income growth toward a concentration of development efforts in those sectors where absolute poverty is concentrated, in the rural areas and to a lesser extent in the urban slums. Such a redirection calls not only for a concentration of capital expenditures (and foreign aid) in the poverty sectors, but also for current expenditures—on education, health,
population control--and changes in economic institutions, such as land
tenure and marketing arrangements in the rural sector, and improvements in
social services, technical training and low-cost housing in urban areas.
These are complex tasks, difficult to organize and manage; but they must be
undertaken if productivity, and with it income, is to grow. Thus, the real
challenge to the leadership of the developing countries in the years ahead
is not so much the set of objectives of the New International Economic
Order, but the humanitarian and political aim of mitigating, and ultimately
eradicating, absolute poverty. On the basis of the same humanitarian and
political objectives, endeavors to do away with absolute poverty commend
themselves to external support both by the "old" rich of the West, and the
"new" rich of the Middle East.

The reference to the problem of absolute poverty, bring to an end
the list of subjects which I mentioned at the beginning of my remarks. Of
course I have not exhausted the set of problems which are likely to arise
and challenge political leaders, economists and other social scientists, not
to mention demagogues and faith healers of social ills. The only subject
which I believe stands out as a glaring omission is the problem of popu-
tion growth. For several reasons I have not included it in my list. For
one, it is implicit in what I have said already; concern about the exhaustion
of natural resources and about the ruin of the environment is of course
valid only in relation to the size of the population and their concentration.
The problem of rural poverty stems of course to a considerable extent from
the deteriorating man/land ratio, i.e. from population growth; conversely,
there is much evidence that suggest that the reduction of absolute poverty
in rural—and urban—areas would go a long way toward reducing population growth. Secondly, the problem of population growth is not time-specific for the next decade; it has been with us for a long time—I suspect it existed even before the Reverend Malthus discovered it—and even if the most optimistic forecast came to pass, it will still be with us ten years from now. And thirdly, I know only enough about the subject and its psychological, political and technical aspects to confess that I know very little.

IV.

This brings me to the end of my remarks. If I were to follow standard procedures, I would now offer a concise summary of what I have said, or what I tried to say. I shall resist the temptation because I am afraid that on the one hand I have not said enough to justify a summary; on the other hand, I have dealt, though in a perfunctory fashion, with so many facets of the issues which I talked about that a summary would be difficult.

I shall also resist the temptation of concluding my remarks with a ringing declaration of unbounded optimism regarding the ability of mankind, or of the leaders of this country, to come to grips with the problems of the next ten years. But I do want to stress once more the interdependence of the issues facing the rich and the poor countries, and the thought that their solutions are interdependent: the flaws in the performance of the economic and political systems of the rich countries are bound to affect adversely their willingness and ability to deal effectively with their relations to the poor countries; conversely, the concentration of the leaders of the poor countries on demands for the solution of their grievances, real or alleged, from the outside will do little to solve their internal problems of absolute poverty. On both sides, problem-solving begins at home, but it does not end there.

April 23, 1976
I found your exchanges on the measurability of the elasticity of the social marginal utility of consumption highly educative for myself. Curiously, I found myself disagreeing in some respects with both your positions. As I see it, you are both agreed that we should look for "objective" measures of the elasticity. Your differences arise from the pursuit of a measure based on consumers' preferences in the one case (Balassa) and "revealed" preferences of the government on the other. I am skeptical about both approaches and would like to record a vote for the determination of welfare weights by an arbitrary and explicitly political process.

(a) Consumer Preferences

There is a powerful appeal in the argument that at the very least social weights on increments of consumption occurring at different levels of consumption should reflect the diminishing weights placed on them by the consumer himself. However, I agree with Lyn Squire that such weights cannot be uniquely defined in terms of the parameters of observed demand relations. It is certainly true that if we can accept the Stone-Geary form of the utility function we can use the Frisch formula to estimate the elasticity but the justification the choice of this particular form becomes entirely arbitrary. It certainly cannot be achieved by appealing to the ability to explain market behavior since any monotonic transformation of this function will yield the same demand relations and is as good a candidate although it will produce a very different measure of the elasticity. There is, therefore, no empirical basis for preferring the elasticity measure associated with one form over the other.

I note that Nick Stern in his recent paper advocating this approach clearly recognizes this problem (page 29) but fineses it by stating that "it must be asserted that the additive form of the function is that which represents the measure of satisfaction." As a piece of historical referencing it is interesting to note that the Samuelson's "Foundations of Economic Analysis" contains the following assessment of the situation:

"It is as meaningless to argue that one particular utility index is really the true measure of utility as it is to argue that the earth really revolves around the sun and not vice versa. Only in terms of observations other than those envisaged in our market place can a cardinal utility magnitude be defined."

And a cardinal measure is precisely what we need. 1/

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1/ Nor will sensitivity analysis help resolve the problem since we have no a priori restrictions on the range of k and the variation in w for different values of k is enormous. w approaches 0 as k approaches to infinity and it approaches 0 as k approaches o.
Incidentally, I found the conclusions listed by Lyn Squire on page 11 somewhat oddly stated. It is surely misleading to state that estimates of the elasticity can only be made for the "canonical form" of the utility function. They can be made for any monotonic transformation provided we care to specify the transformation. In the Stone-Geary case this is simply a matter of defining \( k \) with \( k=1 \) being the special case in which the Frisch formula yields an estimate of \( v \). We can obtain other estimates by setting \( k \) at whatever level we like. Conclusion (iii) is also misleading. It is not only the "canonical form" that implies cardinality. Any specific form once chosen implies cardinality and as pointed out by Balassa, cardinality is not the problem since we are going to have to assume it anyway for interpersonal comparisons.

(b) Revealed Preferences of Government

I disagree with Lyn Squire that measuring the social weights implicit in the tax schedule provides an alternative to the attempt to derive social weights from consumer preferences. I have a number of problems with this approach.

(i) In the first place there is no particular appeal to this approach comparable to the very strong moral appeal in letting the consumers' own preferences determine the weights. Weights implicit in tax schedules at best reflect an explicit political decision process, and as such, they are no more legitimate than weights thrown up by another explicit process. Why not simply ask the planning agency what weights it would like to use? By all means let us show them the weights implicit in the tax schedule as an interesting quantification (and one that will help achieve consistency by iteration), but let us not be too surprised if they come up with a somewhat different set of preferred weights for project analysis. After all, there is no reason to suppose that the government is optimizing with respect to the deployment of its fiscal instruments and if it is not, there is no particular sanctity to the social weights implicit in its tax schedule.

As I see it, this approach is of use only as a part of the "arbitrary" method of defining welfare weights, i.e., option (iii) on page 17. As Squire puts it

"...planners could be confronted with the implicit set of weights underlying a particular policy instrument and asked to assess them. This offers us the possibility, not only of deriving an acceptable social welfare function, but also of making public policy more consistent"...

That is exactly right, but let us then recognize that the basic process is "arbitrary" and the estimated weights are an informational input into this process.
(ii) I have doubts about the practical application of any method of estimating implicit weights. Since governments deploy a number of fiscal instruments (taxes, subsidies, provision of public goods, etc.) it is essential to take an all-inclusive view and determine the net impact of government intervention on all counts. This is obviously no simple task. Certainly, it would be quite wrong to pick any one tax instrument (say personal income taxation) and treat the tax schedule for this instrument as representing the net incidence of fiscal operations.

(iii) Even if we were to obtain an all-inclusive schedule of net tax incidence, what would it tell us? Let us consider the situation in which individual i at income level $Y_i$ is taxed by an amount $a_i$ and individual j at income level $Y_j$ is taxed by an amount $a_j$. The conventional approach is to argue that if the government is optimizing it must be the case that the marginal social cost of raising a unit of tax revenue is equalized across individuals.\(^1\) This means that the social utility of an increment in income at income level $Y_i$ relative to income level $Y_j$ is given by $a_j-a_i$.

It is easily seen, however, that this argument is unacceptable. If we accept that the social utility function should display concavity (a very weak assumption) it can be argued that an optimizing government should always tax the highest income first, levelling down to the next highest and then taxing the second along with the first and so on down the line. This is because the marginal social utility of income is always lower at a higher income level. If (as is likely to be the case in practice) the effective net tax schedule is such that taxes are imposed at income levels below the highest post tax income then at least one of the following must hold:

a) the objective function of the government is not concave;
b) the government does not have flexibility in its deployment of fiscal instruments to tax each level of income at just the desired level, i.e., imposing taxes on the rich leads to some tax incidence on the poor;
c) there are externalities in that taxing income at one level affects incomes generated at other levels, e.g., because of income linkages associated with disincentive effects.

If any of these is true, the net tax schedule is of little use in determining social weights. In practice (b) and (c) are likely to be extremely important in determining the pattern of the effective net tax incidence. I cannot see how a net tax schedule which reflects these considerations provides us with any special information on social weights.

(iv) Finally, there is the general question of the relationship between the distributive impact of the fiscal instruments of government and the dis-

\(^1\) Note that all this assumes that the government has fiscal instruments of sufficient flexibility to achieve any desired net tax incidence, at each income level without affecting any other income level.
tributive impact of project selection decisions. This argument has been made in the past by Bela Balassa and I have never seen an effective response to it. There is an intuitive appeal in the argument that given the constraints on government which determine "feasible redistribution" a government may want to rely more on fiscal instruments and less on project selection. On this view, governments face a choice: the more they do on the one the less they should be doing on the other. However, the approach recommended by Lyn Squire would suggest the opposite. The more progressive the net impact of government fiscal intervention, the more egalitarian the project weights become.

A systematic treatment of this problem requires an explicit statement of the trade-offs involved in the two instruments. Fiscal instruments can be used to achieve distributional objectives (at the expense of some efficiency loss) and so can project analysis. At the margin the government should be deploying each instrument to equalize the marginal trade-offs in each case. In such a situation if we suddenly face an opportunity to improve the use of fiscal instruments to minimize efficiency loss we would expect the government to use the fiscal instrument more intensively and offset this by direct project selection to pursue efficiency objectives.

cc: Messrs. Pyatt
    Kakwani
    Westphal
    Leiserson
Dear Mr. Chotel,

As promised, I'm sending you a copy of my bibliography and 1979 addendum. I also enclose copies of the two new pieces.

Best regards,

[Signature]

Tel. 75893
Room D1302
BOOKS

BY

JOHN HANS ADLER


ARTICLES, COMMENTS, ETC.
by
John Hans Adler

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ADDENDUM TO BIBLIOGRAPHY


ERRATUM

"Trade and Monetary Institutions" by John Adler.
Page 62, penultimate line, first paragraph:

"to the high hopes of the defenders of flexible rates in the early '70s? The"

Substitute a new line:

"to obtain that modicum of international cooperation necessary for"
INTERNATIONAL TRADE AND MONETARY INSTITUTIONS

John H. Adler

INTRODUCTION
This January Ditchley Conference concerned with international economic institutions was designed to focus on the adequacy of the changes recently made or now in prospect in the international 'management' of trade and payments. It convened when the Tokyo round negotiations under GATT were virtually complete and when preparations for the May 1979 UNCTAD meeting were well under way. There had also been substantial recent changes in international monetary arrangements. Considerable experience had now been gained with the system of floating exchange rates sanctioned by the Second Amendment of the Articles of Agreement of the IMF. And the EMS (European Monetary System) seemed likely to come into force shortly. The first part of this essay gives the gist of the conference discussion and is followed by the author's personal comment.

The two opening speakers on trade had been actively involved in the multinational trade negotiations (MTN), 90 per cent complete, but still to be 'sold' to governments, and ratified. The most important innovation in the last round of MTN was agreement on ten codes of conduct on non-tariff barriers, in addition to tariff concessions which, on average, come to 30 per cent of present duties. Elaboration of the codes and agreement on them were the more important since they constitute a collective response to cyclical and structural pressures for protection.

Although there was broad agreement that the virtual conclusion of MTN constituted a major accomplishment in economic diplomacy, it was recognized that the negotiations failed to come to grips with a number of important problems such as the Japanese trade surplus, the difficulties of sectoral adjustments and the need to absorb a larger flow of imports from the LDCs in the markets of developed countries.

The discussion on trade problems fell under four convenient headings: the post-MTN environment, the impact of industrial policy on trade, trade relations with LDCs, and institutional reform.

THE POST-MTN ENVIRONMENT
The talk on this topic mainly dealt with the effects of the imminent completion of GATT negotiations. The new codes are expected to change the
GATT's *modus operandi* radically. Instead of periodic MTN, trade liberalization and the prevention of protectionism will have to be achieved by continuous consultation and the development of case law. Whether the codes work depends on the willingness of governments to make them do so and the effectiveness of the secretariats — and the effectiveness of the new codes could be frustrated if early decisions set bad precedents. We found no answer to the question as to what incentives could induce governments to use the new additions to the GATT machinery but accepted that the main incentive for good behaviour would be fear of retaliation.

There was broad agreement that it was important to make the codes work but that this would be difficult, given the expected slower growth of the world economy, uncertainty regarding the working of the international monetary system, and national preoccupation with domestic macro-economic, sectoral and regional problems. Several speakers thought that ministerial or other high level participation in various GATT organs, especially the Consultation Group of 18 — whose activities had so far been disappointing — could help in that respect. But others, aware of the 'over-politization' of UNCTAD, felt that it would be preferable if GATT were to continue to operate at a low-key technical level.

**INDUSTRIAL POLICY AND TRADE**

The participants showed great interest when one speaker suggested that a major threat to trade liberalization were industrial policies which governments pursued in order to assist some units in the economy to overcome difficulties in production, employment, profitability, etc. But there was a wide range of views as to what constituted 'justified' industrial policies. In one view a distinction should be made between 'liberal' measures which encourage market forces to function effectively, and 'interventionist' measures taken by governments which consider themselves responsible for the size, location and employment creation (or unemployment) of particular industries and sectors. If governments give absolute priority to such interventions, international difficulties caused by them cannot be resolved. Another view started with the assumption that governments are always prone to intervene but that it makes a difference whether interventions are specific with respect to a particular product, a particular company, or a particular location, or are more general. In the first case it was likely that they would be *non-adjusting*: in the second case they could be designed in such a way as to be *adjusting*.

In this connection the inclination of governments to subsidize loss-making activities was mentioned and the danger of creating a vicious circle of slow growth of production and employment leading to protection of inefficiency, which in turn was bound to lead to slower growth and
inflation; and so on. Consideration might be given, it was suggested, to making arrangements for periodic reviews of adjustment policies, similar to annual aid reviews, conducted by the Development Assistance Committee of OECD, or even for a mechanism of surveillance. But it was by no means certain whether such arrangements would make it easier, or more difficult, to pursue positive adjustment policies. Even on economic welfare grounds a case could be made for some adjustment policies which interfered with the growth of efficiency. But many policies were obviously wrong and perhaps one should concentrate on those, in OECD, or in the appropriate code panels of GATT. What was needed was a complaints procedure under which governments could 'complain' when a country's domestic policies hurt their exports. But in view of the 'club' atmosphere among developed countries (DCs), it would be desirable if the newly industrialized countries (NICs) could be persuaded to participate because of their willingness to speak out.

TRADE AND DEVELOPING COUNTRIES
There was also agreement that the recent rapid growth of export-oriented industries in LDCs was an important development on the international trade scene, but this topic was taken up less incisively than were other aspects of trade relations. Because of the inclination of industrialized countries to consider imports from LDCs as a major disturbing element and the main cause of protectionist measures, the question was raised whether trade with LDCs could be seen as part of a solution instead of a part of the problem. After all, the DCs' balance of trade in manufactures with LDCs was strongly positive. Moreover, lending to LDCs, especially to NICs, was a major source of profit for commercial and investment banks. But how could NICs repay their loans, it was asked, unless they could sell manufactures? The NICs should be recognized as a major source of dynamism in the world economy and therefore it was eminently desirable to accommodate their growth and secure the expansion of DC exports to them. There was a difference of opinion on the limits of the freedom of trade and trade liberalization. Some speakers argued that NICs should be advised to reduce the concentration of their exports. Expansion of exports concentrated in a few commodities could easily exceed the rate at which the consumption and production of those commodities in the importing country could be adjusted. Others expressed the view that it would be a mistake to regulate the flow of trade from particular countries. The general view prevailed that cautious application of selective safeguard clauses under the new code of conduct would help rather than hinder liberal trading conditions.

There was some discussion of the respective roles of GATT and UNCTAD
and of the difference in their styles – with GATT operations being characterized as low-keyed and technical and UNCTAD as political and ‘politicized’. One speaker thought that the impact of the LDCs on the MTN was so meagre because of the inability of both DC and LDC governments to bring enough experts with the appropriate skills and competence to the negotiations, and because the representatives of LDCs usually did not have sufficient authority to engage in give-and-take negotiations. And another observed that, prior to the Nairobi meeting of UNCTAD, the DCs had been determined to reject the Common Fund, but finally agreed to it, against their better judgement, on political grounds; the conclusion was that political arguments could not be disregarded. Moreover, it was pointed out, there was still a real possibility that the LDCs would walk out of GATT, chiefly because of the code provision concerning selective application of safeguards.

INSTITUTIONAL CHANGE

A proposal for institutional reform presented by one member aroused much interest and was discussed at length. It was based on the contention that both GATT and UNCTAD had shortcomings, the former mainly for LDCs, the latter for DCs. Under the proposal, a new institution, tentatively called the Production and Trade Organization (PTO), would supersede both, while preserving the valuable functions of each. It would be an umbrella organization with several subsidiary bodies. In order to become members, countries would have to commit themselves to three principles: First, that national action might have adverse effects on other countries and that an affected country could call for a review of the action taken under agreed procedures; secondly, that like situations should be treated alike; and, thirdly, that countries would qualify for the benefits of the rules of the subsidiary bodies only if they accepted the obligations which these rules entail. The subsidiary bodies would be:

‘GATT-Minus’. Essentially this would be the successor organization to the GATT and would consolidate the agreements reached on tariffs and quotas. There might also be a commitment by the members of the GATT-Minus group to eliminate all remaining tariffs in, say, ten years. The DCs would be full members of GATT-Minus, the NICs would become associate members and receive the benefits of further tariff reductions by the DCs on a conditional most-favoured-nation basis, i.e. they would have to make reductions in their own tariffs to obtain these benefits. The poor LDCs would, however, continue to receive tariff reductions unconditionally.

Other Codes. There would also be a series of subsidiary bodies linked to
codes such as those negotiated in the MTN. Membership in these groups would be limited to those accepting the codes. The safeguard code, at least as it now stood, would not be taken over, for part of the purpose of the new institution was to deal directly with problems of adjustment rather than treating them mainly as problems legitimating recourse to exceptions, safeguards, etc. There might also be codes on such questions as direct foreign investment. Agreements on commodities might also be brought under the new umbrella organization in a similar way.

Trade Policy Review Board. This would be a standing group similar in size and composition to the boards of Executive Directors of the IMF or the World Bank. Board members would represent individual countries or constituencies of several countries. The Board would be the central organization for discussion of all trade policy issues and would also have subsidiary panels responsible for investigating complaints.

Advisory Council on the Structure of the Global Economy. This body would be only advisory because it would be impossible for the PTO to tell a member country which industries it should foster and which should be phased out. But it would have important research functions — to analyze trends and assess prospects of industries and commodities.

Standing Group on LDC Trade. This body would take on many of UNCTAD’s present functions, i.e. policies and institutional arrangements in the trade field of special interest to LDCs and should be concerned with the level of protection in LDCs.

Most of the discussion in the conference working Group on trade centered around the PTO proposal and a second one made by another speaker. In the latter’s view, PTO was not an appropriate body for discussing industrial policies. These discussions should not take place in a narrowly defined trade-policy context but in an institutional framework in which they could be linked with discussions on manpower, regional problems, national macro-economic policies, etc.

This speaker also questioned whether the NIC problem could be handled as suggested in the PTO proposal. While undoubtedly true that adjustments in DCs were desirable not just to accommodate NICs but also to enable DCs to enjoy efficiency and volume gains from trade, the political solidarity of the Group of 77 would interfere with attempts to deal with NIC problems as distinct from those of other LDCs. He also argued against making most-favoured-nations’ treatment of NICs conditional: better, he said, to preserve their access to the DC markets and to press them to liberalize their imports and remove export subsidies; and to appreciate gradually their currencies and raise real wages as productivity
increases. Exchange rate policies were of special importance since most NIC currencies were pegged to the dollar. One possible alternative to the proposed PTO subsidiary body on LDC trade would be to discuss these issues with a limited number of NICs through some special OECD consultative arrangements.

The reactions of other members to the PTO proposal reflected some scepticism (on political grounds) and the belief that the existing institutions were about as good as could be expected. Little they argued, could be changed by organizational reform, because the problems of the existing institutions reflect real political difficulties which would remain the same for a new organisation. Similarly, the substantive issues would remain the same—e.g. how to make the complaints procedure work. More was being achieved in bilateral negotiations than in many international forums and it was unrealistic to expect tariffs to be completely eliminated in the foreseeable future.

Others responded more favourably to the PTO idea, feeling that something new was needed, and something less technical and legalistic than GATT and less political and self-righteous than UNCTAD. The debate also tended to bear out the view of the introducer of the proposal that thinking through the scope of the new institutions in itself tended to illuminate usefully the problems of the existing organisations. The PTO was not something for today. It was important first to complete and to ratify the outcome of the MTN. But there was a need to begin the process of thinking about what should come next.

**MONETARY ISSUES**

The opening speaker on monetary issues asserted that the present situation did not deserve to be referred to as a monetary 'system'. The complaints most frequently levied against the current monetary arrangements are: too many fluctuations of exchange rates; frequent overshooting and undershooting of rates; the overhang of foreign exchange holdings; the interference of capital movements (and of attempts to bring them under control) with monetary policy; and the persistence of imbalances in international accounts.

According to the speaker, only two of these complaints cause serious concern—the undershooting of exchange adjustments (because it threatens balance of payments adjustments and may in certain circumstances cause unemployment) and the fact that the present 'system' allows imbalances to continue for a long time (thereby bringing about lower levels of output and incidentally, enhancing the trend toward protectionist responses).

As to the need for changed institutional arrangements, he expressed the view that there is no need for further monetary reform but that there is urgent need for multilateral surveillance of general economic policies.
These introductory remarks were supplemented by the second speaker who elaborated on the current global macro-economic situation. He felt that stagflation would continue for some time – at different rates in different countries. US monetary policy was likely to follow a wavering path between weak restraints and weak expansion, with inflation remaining high, but a recession would be avoided. What was needed was an arrangement for the coordination of monetary policy, but this was not likely to be accomplished for some time.

Since there was a diversity of views on monetary issues, the members spent some time on an analysis of events leading up to the current situation. There was a fair degree of consensus on their causes but not on corrective actions.

**Diagnosis of the current situation**

The international monetary problems can be viewed as resulting from a clash between two powerful sets of forces: a large increase in the importance of the foreign sector of most countries; and a large increase in the demands made by electorates on their governments. From the viewpoint of those charged with managing the national economies, the costs of increased openness at the borders appear exceedingly high; but so too are the costs of withdrawal.

The US dollar, the monetary working Group thought, could effectively serve as the key currency in the world only as long as the foreign sector of the US economy remained large, relative to the world economy, thereby generating a large supply of and demand for dollars; and at the same time the prevailing expectation in the world was that the dollar would remain relatively stable. Over the years, however, both conditions have been imperilled. Some attributed the weakening of the US dollar to an overvalued rate; some to an easy US monetary policy that laid the basis for heavy capital exports.

The Group were not all agreed on the underlying economic working of the international monetary system. There was frequent acknowledgement of the importance of various political and institutional factors in affecting the system, such as differences in the behaviour of labour unions in different countries. At the same time, they agreed that the degree of instability under the present régime of flexible rates, dominated by an unstable dollar, was unsatisfactory on various grounds:

There was the troublesome phenomenon of overshooting in such rates, partly due to the existence of some destabilizing speculation, the possibilities for which were thought to be greater than in years past because of the size of the supply of offshore dollars, coupled with a
higher propensity to shift currencies on the part of traders, investors and multinational corporations. In such circumstances the risks of disequilibrium associated with exogenous shocks, such as the oil crisis, are heightened.

There are asymmetrical pressures on debtor and creditor countries; debtors are effectively pressed to contract, but creditors are not effectively pushed to expand. The net effect is reduced global growth.

There may be an asymmetrical impact on prices, with devaluations producing price increases, but revaluations not producing equal price decreases.

It was also suggested by one member that the stagflation phenomenon might be due in part to the national responses to variable rates: restrictive credit policies in the devaluing countries and reduced profits in the revaluing countries.

The present system, it seemed agreed, also confronts three special problems that focus on the US: First, if the US deflates, growth will be stifled; if it inflates, the dollar will be weakened. Secondly, with 80 per cent of the foreign currency holdings of the world now in dollars, the possibility exists that holders will want to reduce that proportion whenever the opportunity arises. Thirdly, the US dollar role puts a burden on the US to "behave itself" in the interests of global stability. But no nation responds to that kind of demand very effectively. In the US case, the likelihood that it will respond is imperilled further by its internal division of governmental powers and relative sense of invulnerability.

A caution was expressed that this list of shortcomings should not lead the Group back to supporting the pegging of rates, which some thought would be retrogression.

As regards the LDCs, the Group felt that their various problems were likely to come up more in the trade than in the monetary field. Most LDC currencies are linked to other major currencies - more of them to the dollar than to any other. The oil-exporters aside, most such countries are dollar debtors. Some LDCs selling dollar-denominated exports have been hurt by that fact. But so far devaluation appears to have helped them on balance.

PRESCRIPTIONS

Despite the acknowledged inadequacies of the existing reserve system the proposed alternatives were limited in number and scope.

Reservations were expressed about encouraging a reserve system composed of two or more national currencies, e.g. by turning the DM and
the Yen into reserve currencies, alongside the dollar, even if acceptable to Germany and Japan. The switching possibilities, it was thought, would introduce new elements of instability. On the other hand, measures to deal with such switching possibilities could presumably be developed.

It was thought unrealistic to entertain the possibility of the European Currency Unit in a reserve currency role, at least for the next decade: first because the position of the ECU itself was still so limited and so uncertain; secondly, even if the ECU should emerge as a transaction and credit medium, Europe could be expected to resist its use by non-Europeans as a reserve currency.

Some sentiment was expressed for building up the role of the SDR as a reserve currency. This would eventually require widening the SDR's functions beyond its present role as a unit-of-account for central bank settlements, so that eventually it would become a medium for transactions, credit and reserves, available to the private as well as the public sector. It was agreed at the same time that, insofar as the SDR was weighted by dollars, the problem of dollar stability in a reserve medium would still be present; a hard national currency might still be preferred.

The question whether the European Monetary System was likely to bring about greater stability vis-a-vis the dollar than the existing system led to no consensus. The question whether an EMS bloc was likely to generate more co-operation with the dollar led to the conclusion that the outcome was indeterminate. More co-operation could ensue; but it was also possible that it would close ranks against a falling dollar. In any event it was still too early to speculate on the long-run meaning of the EMS.

The IMF was seen as moving into a period of strong expansion. With agreements on the Witteveen facility and a 50 per cent quota increase in hand, prospects for an expanded role looked good. On the other hand, there was no serious prospect that the IMF would be able to bring private loans to the LDCs under its control; the resistance of both the LDCs and the banks to such a proposal seemed to eliminate any serious discussion.

REFLECTIONS

The comments that follow record some personal thoughts on what was discussed at the conference and on the discussion itself. They are a mixture of preconceived notions with which this member came to Ditchley, and of afterthoughts on the ideas and convictions of others present, especially the 'practitioners' and their 'gurus' and how these ideas stood the test of response and rebuttal.

An intriguing thought occurred to me shortly after the conference began. I asked myself: How different would the discussions have been if they had been held three years earlier, in January 1976? Leaving aside the pre-
occupation at that time with the price of oil and the rapid accumulation of
foreign exchange holdings of most OPEC members — two subjects barely
mentioned during the conference — I am confident the newly
emerging system of flexible exchange rates would have received much
higher marks than it did at this conference. True, there was close to
unanimous consensus that a return to fixed rates was not in the cards; but
the system of flexible rates was strongly criticized — for overshooting and
undershooting, for being defenceless against speculative intervention in the
market, for too many official interventions — ‘dirty floating’ — and so on.
Clearly, more ‘orderly’ exchange markets appear desirable. What happened
to the high hopes of the defenders of flexible rates in the early ‘70s? The
endorsement which the conference gave to the flexible system took the
form of a gentle pat on the back, of expressions of hope that with some
international good will and good sense it could be made to perform
reasonably well. But it was far from a firm embrace. Rather it was the
disillusioned acceptance of a second-best solution, the embodiment of the
possible in a very imperfect world in which the pre-occupation with
domestic, regional and sectoral problems made it difficult or impossible
to the high hopes of the defenders of flexible rates in the early ‘70s? The
‘reasonably’ well functioning global system of trade and payments.

Another perhaps more fundamental difference between the attitudes
apparent at this conference, and what they presumably would have been
three (or four or five) years ago, was the acceptance, without blinking, of
slower growth rates and the consequences for some years to come. In
1976, when the world economy emerged from the trauma of a fourfold
increase in the cost of oil, and tried rather gingerly to live with flexible
exchange rates and ‘abnormal’ balance of payments surpluses, in a style
to which it was not accustomed, it was taken for granted that the growth
of production of the OECD economies would in due course — certainly
before 1980 — move back ‘on trend’ of, say, 4.5 per cent a year. The
suggestion that the growth would be substantially lower would have been
declared historically unfounded and ‘defeatist’. Now the ‘high hope’ is
that if everything goes well the US economy will ‘conform’ and slow down
to a growth rate of 2 per cent and that the slower rate will help balance the
US international accounts and make the dollar more resilient. O tempora,
o mores.

The prospects of slower growth were of course repeatedly referred to at
the conference, particularly in connection with the growth of exports and
manufactures from LDCs and resistance of DCs to let them in and thereby
aggravate the adjustment problems of the industries directly affected by
the imports. The discussion of trade with LDCs, which was rather brief,
reflected, I thought, the attitude prevalent in most DCs, of recognizing the
existence of a problem without being ready and willing to deal with it. Whatever the specific difficulties are — and they obviously vary from country to country — the members from the DCs took some comfort from being able to fall back on the argument that their governments' ability to make concessions is, under present conditions of slow growth, strictly limited. And even some of the most ardent proponents of most-favoured-nation treatment are willing not just to defend, but to endorse, the selective use of safeguards against 'disruptive' imports from LDCs.

The inability of the Tokyo round negotiations to come to grips with increased exports of manufactures from the NICs and the likelihood — and desirability — of further increases, is probably the most serious flaw. It lends plausibility to the comments made at Ditchley — and by knowledgeable observers — that the real accomplishment of the MTN was not a further advance towards trade liberalization but the prevention of an advance of protectionism. Some commentators would not even go so far. They argue that the outcome is still uncertain and that the results of MTN will depend on the way in which the new codes are interpreted and applied by the gradual evolution of case law, that peculiarly Anglo-Saxon institutional embodiment of permissiveness.

To compare once more the current way of looking at the issues with three years ago, it is quite sure that in 1976 nobody with any sort of historical perspective would have thought it likely, or even possible, that the Euromarket would become by far the most important source of capital to meet the short-term needs of industrialized countries, the longer-term needs of the centrally planned economies of Eastern Europe, and what by all accounts must be considered the long-term needs of LDCs, especially the NICs. True, in January 1976 private banks and bankers were already involved in Eurocredit operations and provided not only large amounts of credits to borrowers in industrialized countries, but also medium and long-term funds to NICs (and a few other LDCs) sufficient to enable them to maintain their growth momentum in the face of adverse effects of the oil crisis on their export earnings. But it was generally thought that this new addition to the international flow of development finance was a strictly temporary phenomenon and that it would disappear shortly — as soon as the demand for investment capital in industrialised countries would expand in line with the resumption of their GNP growth.

Well, as we now know, the fears of 1976 have proved unfounded — so far. The demand for loans in industrialised countries remained modest and the Euromarket's updated version of Gresham's Law — that good borrowers drive out risky borrowers — did not materialize. The flow of loans to NICs, other LDCs and Eastern Europe continued to grow and gained momentum of its own. And there was no indication of any decrease
in the supply of funds, although the rate of accumulation of foreign exchange holdings of OPEC countries declined appreciably in recent years. A member noted that net additions of international private lending in the last twelve months were $60 billion from private sources, compared with $5 billion from the IMF. Other sources suggest that perhaps as much as one half of that $60 billion goes to LDCs and Eastern Europe, notwithstanding considerable uneasiness of some lending institutions and many monetary authorities.

The magnitude of Euromarket loans (discussed in the preceding paragraph) received only scant attention at Ditchley and should be given more. The omission from the agenda of the third pillar of international economic institutions — development assistance — was intentional, while members decided — for want of time — not to discuss commodity agreements and intra-LDC trade. There were other topics that the conference touched on briefly. They were not, as such, on the agenda (and, had they been, we would still be at Ditchley Park around the conference table!). But they cry out for examination. First, multinational corporations: they cause short-term capital movements (and hence exchange rate fluctuations); they create half of all world trade; they press, sometimes, for protectionism in the countries where they produce. Secondly foreign investment: it too affects capital movement and is a substitute for borrowing. Thirdly, the implications of China's current opening into the world economy: in 1978 her foreign trade was of the order of 1 per cent of world trade, but her potential is enormous.

AGENDA FOR THE FUTURE

This brings me to my concluding comment. The conference showed, at least to me, that the discussion of the topics under consideration is open-ended and no lasting conclusion can ever be reached. New developments reflecting human ingenuity, and new problems reflecting human cussedness arise constantly and have to be dealt with — by civil servants, officials of international institutions, academics, legal experts and 'idea men'. The conference (and I hope my comments) have shown not only the desirability of further discussions. They also suggest the need for a change in the institutional-organizational framework where the problems which are now neglected can be taken up and, more generally, where the changing events, and needs of the world economy can be systematically observed and analysed, and where their consequences can be incorporated into the system of rights and obligations of the comity of nations. On further reflection following the conference I believe that the PTO proposal reported above would make an admirable point of departure for deliberations and ultimate action along that line.
Entwicklungshilfe im Kreuzfeuer der Kritik

Von John Adler, Oxford


Vier Kritikansätze

- Die armutsorientierte neue Strategie der ländlichen Entwicklung berücksichtige die Armut als ein Phänomen, das auf dem Lande nicht - die besitzlosen Landarbeiter. Dieses Vorgehen garantiere andererseits die Sicherheit des Landbesitzes für die Eigentümer.
- Projekte der ländlichen Entwicklung würden nicht von den Kleinbauern selbst geplant, sondern ihnen von den herrschenden Klassen und den elitären Technokräften (den ländlichen und den internationalen) aufgetragen.
- Die neue Betonung der armutsorientierten ländlichen Entwicklung sei nur ein heuchlerischer Versuch, die bestehende soziale und politische Ordnung in den armen Ländern zu erhalten. Das wahre Ziel der ländlichen Entwicklungsstrategie sei es, die durchgreifende Industrialisierung armer Länder zu verhindern und sie in wirtschaftlicher und politischer Abhängigkeit von den reichen Ländern zu halten.

Auch der ersten drei dieser kritischen Behauptungen vermülliger und plausibler zu sein - und deswegen ist auch ihre Widerlegung schwieriger. Kein internationaler oder nationaler Entwicklungsexpertise kann ehrlicherweise behaupten, er wisse genau, wie die ländliche Armut zu beheben sei. Wer jemals mit solchen Problemen zu tun hätte, muss zugeben, dass sie schwierig und qualvoll sind und dass es in der Tat nie von vornherein feststeht, ob ein bestimmtes Projekt auch tatsächlich die kleinbäuerliche Zielgruppe erreicht.

Kleinbauern profitieren

Aber konkrete Resultate treten doch langsam zutage, trotz alle Problemen und dem Mangel an Erfahrung. Die

Der Autor

Der Autor dieses Beitrags, Dr. John Adler, ist ein ehemaliger nationaler Experte, der als Osterreicher in der Weltbank-Hierarchie in Washington D.C., USA, zum Direktor der Budget- und Planungsabteilung aufstieg. Gegenwärtig beschäftigt sich der Autor an der Universität Oxford mit Forschungsarbeiten und tritt sporadisch auch publizistisch für das Gedankengut und die Politik der Weltbank in Erscheinung.

* In der Rubrik «Die Tribüne» veröffentlichen wir Beiträge von Autoren, die nicht regelmässig Mitarbeiter des «Tages-Anzeigers» sind und deren Meinung sich mit derjenigen der Redaktion nicht zu decken braucht.

Im übrigen kann man mit den Kritikern darin übereinstimmen, dass die Verringerung und die schliessliche Beseitigung der Armut nicht dadurch erreicht werden kann, dass man darauf wartet, bis die Ergebnisse des Wirtschaftswachstums bis zu den Armen (trickle down). Deswegen besteht die einzige Alternative darin, dem armen Landbewohnern die Unterstützung direkt zukommen zu lassen - und das ist eben nicht leicht. Aber selbst wenn nur die Hälfte des Nutzens ländlicher Entwicklungs hilfe die Kleinbauern erreicht, zeichnet sich schon ein echter Durchbruch ab.

Armuts kontra Politik


Was nun die letzte Gruppe der kritischen Argumente anbelangt, so scheint es, dass man der Idee der ländlichen Entwicklung Schaden zufügen würde, wenn man sie zu ernst nähme. Die revolutionären Intellektuellen, die solche Angriffe vorbringen, haben letztlich kein Interesse am Schicksal der Armen in der dritten Welt. Ihre Behauptung, die Entwicklungsarbeit sei nur Teil einer globalen kapitalistischen Verschwörung, gründet sich auf ein skurriles und schlecht durchdachtes Geschichtsbild. Wollte man solchen Anschuldigungen ernsthaft entgegen, müsste man in eine politische Diskussion über die Struktur der Weltwirtschaft und die sie bewegenden Kräfte eintreten. Das wäre jedoch eine Verschwendung von Zeit und Energie, die sich besser im Kampf gegen die Armut einsetzen liessen. Nur zu diskutieren und zu warten, bis sich die Weltwirtschaft verändert hat, wäre im Hinblick auf die reale Armut unmoralisch und grausam.
BANK FOR RECONSTRUCTION AND DEVELOPMENT, INTERNATIONAL

by

John Hans Adler

FROM

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1973

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WILLIAM BENTON, Publisher
Luka was an important military centre. They built many mosques, of which Fethiyya is the most beautiful. The town is the seat of a Roman Catholic and also an Orthodox bishop. There is an important annual stock and produce fair, at which horse racing is a popular feature. In the town there exist the remains of Roman forts as well as of the Roman baths. In the 19th century Banja Luka played an important part in the uprisings of the Serbs against the Turks and during the course of World War II partisans liberated Banja Luka three times. The town had an industrial section built after World War II. In Oct. 1969 the town was devastated by earthquakes that destroyed over half of the buildings and injured hundreds.

BANJO, a stringed instrument originating in North America, apparently associated in the first place with the Negro population, which may have given it its name from the banaleju of the Congo region. It is the only modern stringed instrument of western origin that employs a stretched skin membrane as the soundboard or belly. The circular body consisted originally of a wooden drumlike shell, open at the back, to which the skin, or vellum, was nailed. Later a “flesh-hoop” was introduced, with screw stretchers for varying the tension of the “head.” The long neck, or handle, is “stepped in” to the body; its shank fitting into mortises at the top and bottom. Here again, the banjo is unique among western instruments in using this primitive stick-and-resonator construction, but allowing the tension, the pull of the strings is taken by this central member.

The first banjos had either nine or seven strings; six of the full-speaking length of the neck (about 24 in.), and often one to three shorter strings, about 16 in. long, the tuning pegs and nut being mounted on a thickening of the neck on the bass, or thumb, side nearest the player. These short high-pitched strings were played only by the thumb and intended to complete the contour of melodies or upper parts of chords without awkward shifting of the hand. The strings were of gut, and passed from the pegs over a pressure bridge to a violin-type tailpiece or string holder at the bottom end. The neck was unfretted, like a violin finger board.

The popularity of the banjo among English-speaking peoples reached a climax in the last two decades of the 19th century, when the number of strings became more or less standardized at five, four of the ordinary length plus the short chanterelle or thumb string, tuned thus:

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String No. 1

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<th>2</th>
<th>3</th>
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<tr>
<td>Chanterelle</td>
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but sounding an octave lower than the written notes. Of these, the fourth (C) string was of silk, covered with fine copper wire, and the others usually of gut (later sometimes replaced by silk, with an occasional first string of steel). Tuning was by means of violin-type pegs mounted in the flat head. Later a screw adjuster was used to keep the pegs bearing properly without either jamming or slipping.

About 1890 the more sophisticated zither-banjo was introduced. The chief difference was in the body, the vellum being of smaller diameter and mounted in a frame suspended within a hollow-box resonator with a closed back, which threw the sound forward. The fingerboard was fitted with fixed metal frets, like the violin, the number eventually reaching as many as 24. Metal frets began to be used on the ordinary banjo about the same time. Since zithers use steel wire for strings 1, 2 and 5; they were fitted with' “machine heads”: i.e., screw-and-wheel adjusters for the pegs. A peculiarity of these machines was that they included a sixth peg for symmetry, although it was permanently useless. The chanterelle was tuned from the head, the unused part of the string passing beneath the finger board, to emerge at the fifth fret. This enabled the old excursion and peg to be done away with, and the neck became streamlined for greater technical facility.

Other sizes of the banjo have included at various times the piccolo banjo, tuned an octave higher, the banjoroverine, a fifth higher, and bass and contrabass instruments. Banjo-type instruments have also been adapted to the pitch and tuning of the mandolin, with four pairs of steel strings; and, in miniature form, to the ukulele, with four single gut strings. The tenor banjo is common. It is rather shorter than the standard instrument, with four strings only, tuned in fifths at viola pitch. The traditional technique is plucking with the fingers, but with modern instruments the plectrum is also used.

BANK, SAVINGS: see SAVINGS BANK.

BANKER MARKS (Masons' Marks) cut upon the dressed stones of a building (though rarely seen on tracery or carved work), were apparently the personal trade-marks of masons working the stone at the banker (Ital. banco), or stonecutters' bench. They are to be seen widely in Europe from Roman times to the present, but most frequently on medieval work, when they were cut on the exposed face; since then they have been cut on the bed to avoid disfigurement. In Gt. Britain they were used by important masons as personal badges. These personal marks were often passed from father to son. From the 16th century, when others besides working masons were admitted to masonic guild lodges, they too were allocated banker marks, which were entered in the lodge register.


BANK FOR INTERNATIONAL SETTLEMENTS. The Bank for International Settlements (BIS) at Basel, Switz., was created with two purposes in mind: (1) to provide an agency to handle the payment of reparations by Germany after World War I (see Reaparations); and (2) to establish an institution for cooperation among the central banks of different countries (see Central Bank). The objects of the bank were stated as follows in its statutes:

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...to promote the co-operation of central banks and to provide additional facilities for international financial operations; and to act as trustee or agent in regard to international financial settlements entrusted to it under agreements with the parties concerned.
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A committee drew up the basic documents creating the bank in 1929; the Hague Conference of 1930 confirmed them, and the bank started business on May 17, 1930. The bank's capital was fixed originally at 500,000,000 gold francs, but as of Sept. 30, 1970, its authorized capital was 1,500,000,000 gold francs, divided into 600,000 shares of 2,500 gold francs each. At the end of the financial year 1967-70 there were 448,319 shares in issue, paid up to 25% of nominal value. Subscription of the capital was originally guaranteed in equal parts by the central banks of Belgium, France, Germany, Great Britain, and Italy and by two banking groups, one Japanese and the other from the United States. The shares issued to the Japanese banking group were repurchased in 1952 by those of the European central banks which originally guaranteed the
subscription of the bank's capital, the Japanese government hav­
ing renounced in 1951 all its rights concerning the bank. In the early 1970s most of the U.S. shares were in European hands and the membership of the BIS extended to all European central banks except those of U.S.S.R. On June 30, 1971, the South African Reserve Bank became the 30th member.

At the outset the bank was to receive reparations payments from Germany and allocate the proper share to each creditor nation. Under the impact of financial crisis, however, Germany's payments of the reparations provided for in the Young Plan (see Young, Owen D.) were suspended by the Hoover moratorium of July 1932. The bank was active in attempts to counteract the crisis and participated in the granting of international credits. Within the framework of the Young Plan, it had made certain investments in Germany, the total of which was established in 1932 at about 300,000,000 gold francs. An agreement was concluded in 1953 with the Federal Republic of Germany for the settlement of these investments.

The total of the bank's balance sheet on Sept. 30, 1970, was 20,660,461,014 gold francs. About 26% of this was in gold, 62% in time deposits and advances, and the remainder in securities, treasury bills, cash, and miscellaneous items. The bank may buy and sell gold, currencies, and short-term obligations of prime liquidity, and government securities.

Under its statutes the bank may undertake only operations that are in conformity with the monetary policy of the countries concerned. Its operations have been short term, both as regards its granting of credits and its purchases and sales of gold and foreign exchange. The bank showed a profit every year, except for 1945. Dividend payments were suspended then but resumed in 1951.

In 1947 the bank was appointed agent for the execution of the first intra-European compensation agreement initiated under the Marshall Plan (q.v.) and in 1950 it became agent for the Organization for European Economic Cooperation in respect of the European Payments Union. After the liquidation of the latter at the end of 1958, the bank was appointed agent of the OEEC (later of the Organization for Economic Cooperation and Development) in respect of the European monetary agreement.

In 1934 the bank was invited to undertake certain functions as depository under the terms of an act of pledge concluded with the high authority of the European Coal and Steel Community. The monetary and economic department of the bank is responsible for the preparation of the bank's annual report. It has also made special studies, at the request of the central bank concerned, of the economic and financial position of a number of special areas, including Austria, France, Italy, and the sterling area. See European Unity.

The bank is thus an international bank which makes its services available to the European central banks, a centre for economic and monetary research and consultation, and a technical agent for the execution of certain specific agreements. The founders of the bank attached great importance to the permanent contacts which the bank would make possible between officials of different central banks. Apart from the war years, the central-bank governors who are members of the board of directors have held regular monthly meetings in Basel, and the governors of other central banks have attended annual meetings and made other occasional visits. See also International Payments.

BANK FOR RECONSTRUCTION AND DEVELOPMENT, INTERNATIONAL, was established as an international organization, designed to help finance sound projects for reconstruction and development—reconstruction in war-devastated countries and development of world economic resources, particularly in underdeveloped regions. Commonly known as the World Bank, it had its origin in preparations for postwar international financial and economic cooperation that culminated in the United Nations Monetary and Financial Conference held in July 1944 at Bretton Woods, N.H. Out of that conference, at which 44 nations were represented, grew two complementary, but separate, organizations: the International Bank and the International Monetary Fund.

The bank came into existence on Dec. 27, 1945, when the articles of agreement—(charter) were signed by 29 governments. The bank officially began operations at its headquarters in Wash­ington, D.C., in June 1946. Twenty-five years later, the bank had 117 member countries.

The principal purposes of the bank, set forth in its articles of agreement, may be summarized as follows: (1) to assist in the reconstruction and development of member countries by facilitating the investment of capital, and promoting the long-range growth of international trade and the improvement of standards of living; (2) to promote private foreign investment by guarantees of, and participation in, loans and other investments made by private creditors; (3) to make loans for productive purposes out of its own resources or funds borrowed by it when private capital is not available on reasonable terms. In practice, the bank has engaged only in direct lending operations.

Lending Operations.—The first loans by the bank were made for urgently needed reconstruction in several European countries whose economies had been damaged by World War II. By 1949, however, emphasis in the bank's lending had shifted to developing productive facilities and resources, particularly of the bank's eco­nomically less developed member countries. By the end of 1971 the bank was the largest multilateral source of development financing in the world. It had granted over 800 loans totaling the equiv­alent of more than $16,000,000,000 (net of cancellations and refin­dings through subsequent loan operations) to 90 countries. Loans were made in Africa, Asia, the Middle East, Oceania, Europe, and Latin America. In addition, the bank had extended lines of credit of $270,000,000 to the International Finance Corporation (q.v.). Disbursements amounted to nearly $12,000,000,000.

Since the bank is primarily a source of long-term loan capital, its resources have been used largely to assist in the financing of investments for which considerable amounts of such capital are required and for which this method of financing is appropriate. Therefore, about two-thirds or more than $10,000,000,000, of the bank's portfolio consists of loans for the generation and distribution of electric power and transportation, including roads, ports and inland waterways, pipelines, and airports. About $4,000,000,000 has been lent to industrial enterprises and development finance companies, which in turn finance industrial activities and the expansion of agricultural production. Agricultural loans have been for irrigation, drainage and flood control, farm mechanization, land clearance and improvement, crop processing and storage, live­stock development, fertilizer production, the fishing industry, and forestry. Among such loans have been one of $4,000,000 to assist Guatemalan cattle ranchers to increase beef output by improving pastures and cattle-raising techniques, and one of $14,000,000 for rice processing and storage in the Philippines.

The bank's portfolio (about $2,000,000) has financed education, especially vocational training and secondary schooling; sanitary installations, such as water supply, sewerage, and pollution control systems; telecommunications; tourism; family planning; and general development and industrial imports. The emphasis on the development of agriculture and education increased markedly during the 1960s. The bank's assistance to education included $35,000,000 for vocational, technical, and management training in Turkey, as well as a long-term plan for educational television in the Ivory Coast.

The bank has also come to the rescue at times of natural disas­ters. In November 1970, when giant tidal waves from the Bay of Bengal pounded the Ganges-Brahmaputra Delta and its offshore islands and coastal districts, causing possibly as many as 600,000 deaths, the bank's affiliate, the International Development Association, approved a $25,000,000 credit to finance key elements in a $180,000,000 reconstruction program.

Source of Bank Funds.—The bank obtains its funds for loans from paid-in capital subscriptions, from borrowings in the capital markets of the world, and from net earnings. Sales to investors of portions of the bank's loan portfolio and repayments of loans to the bank, while representing only a recovery of funds originally derived from one of the above sources, have the same effect as new capital in that they reduce the amount the bank would otherwise have to borrow from other sources. These capital movements provide...
the largest amount of funds for loans. By the end of 1971 the bank's outstanding funded debt amounted to nearly $7,700,000,000. Loan funds available from other sources were nearly $4,800,000,000 from capital subscriptions; about $1,300,000,000 from net earnings; and $4,800,000,000 from repayments and sales of loans.

Lending Policies and Procedures.—The bank's loans must be for high-priority productive purposes and, except in special circumstances, must be used to meet the foreign exchange requirements of the borrower, are made only to member governments. A member government or one of its political subdivisions, or an industrial or agricultural enterprise in the territory the project is located. The articles of agreement enjoin the bank to act "prudently" in making loans, paying "due regard to the prospects that the borrower, and, if the borrower is not a member, that the guarantor, will be in a position to meet its obligations under the loan." The bank is also specifically required to make arrangements to ensure that the proceeds of each loan are used only for the purposes for which the loan was granted and to pay attention to economy and efficiency.

The articles contain three other important provisions governing the bank's operations. The first is that the bank must be satisfied before making any loan that the borrower would be unable to obtain the loan from other sources on reasonable terms. Second, the bank is prohibited from making loans; that is, the proceeds may be spent in any member country and Switzerland, although not a member, has provided resources to the bank and has a special relationship with it. Third, only economic considerations are considered relevant to the bank's decisions; it must not be influenced by the political character of the member or members concerned.

The lending operations of the bank are formulated and evaluated within the framework of a country's development program. The bank maintains a close working relationship with borrowing governments, assisting them in the formulation of development programs, and working with them on the preparation of high priority projects for external financing. In 1964, when the bank decided to increase its lending for agriculture and education, it entered into agreements with the Food and Agriculture Organization of the United Nations and UNESCO for cooperative programs under which those two institutions work with the bank in their respective fields by assisting governments to identify and prepare projects for bank financing.

A similar arrangement was made with the World Health Organization in 1971 for water-supply projects. In assessing any particular project for financing, the bank makes an appraisal that usually involves the investigation of six different aspects: economic, technical, organizational, managerial, operational, and financial. The economic aspect of the appraisal is fundamental since the bank does not finance a project unless it can be demonstrated that it represents a high priority use of the country's resources.

Technical Assistance.—In addition to financial assistance, the bank, as a service to its member-countries, furnishes technical assistance, both in connection with, and partly independently of, its loan operations. Developing countries, as has been indicated, are helped in identifying and preparing projects and analyzing their economies, and also in formulating appropriate development policies, establishing effective development institutions, preparing investment programs, studying sector development, determining project and other priorities, testing the feasibility of individual projects, and finding solutions to particular problems.

In 1955, as part of its technical assistance activities, the bank established the Economic Development Institute, a training center for government officials of developing countries and territories concerned with the formulation and execution of development policies and programs. The institute offers an intensive six-month seminar in which economic problems of those countries are analyzed (to a large extent on the basis of the bank's experience with its member countries) and in which the participating officials have an opportunity to exchange their own views and experiences. In addition, the institute offers courses dealing with the preparation and evaluation of projects, either generally or in especially important sectors such as infrastructure, industry, and agriculture.

Capital Structure.—The bank's capital is derived from subscriptions to shares of capital stock by its member countries. Members' subscriptions generally are in proportion to their economic resources. The bank was established, its authorized capital was $10,000,000,000. Of that amount, only 20% was paid in by member countries, partly in gold and partly in their national currencies; 80% remained on call and served to support the bank in its borrowing operations in the money markets of the world. By the late 1950s, with the funded debt of the bank approaching $7,000,000,000, it was clear that the continued high rate of demand on the bank for development loans meant that it would frequently have to go to the market to borrow funds for its operations. Therefore, in September 1959, the authorized capital was increased to $21,000,000,000, and each member was asked to double its subscription, the additional capital to remain on call. The effect was to provide massive additional guarantee resources to serve as backing for the bank's sales of its securities to investors. Subsequently, as the capital subscriptions of certain members were increased and as new countries became members, the bank's capital structure was expanded further. By 1971, the authorized capital was $27,000,000,000 and the subscribed capital had risen to some $24,000,000,000. Of this amount, nearly $2,000,000,000 was available to the bank for operations.

Marketing Operations.—The bank began its borrowing operations in 1947 when two bond issues totaling $250,000,000 were sold publicly in the United States. As the bank succeeded in broadening the market for its issues on an international scale, there were over 100 issues of securities outstanding by the end of 1971, aggregating about $5,200,000,000, held by investors in about 80 countries. The outstanding securities were denominated in U.S. dollars, Canadian dollars, Deutsche marks, Belgian francs, Japanese yen, Libyan pounds, Italian lire, Kuwaiti dinars, Netherlands guilders, British pounds sterling, Swedish kronor, and Swiss francs. The maturities and other terms affecting the bank's issues are determined by market conditions and the requirements of the bank. The bank also sells to financial institutions the securities it receives from borrowers in connection with its loans. In this way, as well as by its own borrowings, the bank acts as a channel for the flow of private capital into international investment. By the end of 1971 the bank had sold, or had agreed to sell, to investors the equivalent of $7,400,000,000 from its loan portfolio.

Interest Charges and Financial Results.—Interest and other charges are on a nondiscriminatory basis without distinction among borrowers. The rate of interest charged by the bank on its loans is kept as low as is compatible with the need to maintain the bank's financial strength and reputation. From 1953 to 1971 the interest rate ranged from 4 to 7 1/2 Warning.

In the fiscal year 1971, the bank's net income amounted to $212,546,000. Of that total, $110,000,000 was transferred to the International Development Association (see below) as a grant. At the same time, $102,000,000 was placed in the supplemental reserve against losses on loans and guarantees, bringing that reserve to over $1,254,000,000. The special reserve, derived from loan commissions on the bank's earlier loans, amounted to $292,200,000, bringing total reserves to $1,546,000,000.

Administrative Organization.—The bank's charter provides for an administration composed of a board of governors, a board of executive directors, a president, and staff. All powers of the bank are vested in the board of governors consisting of a representative appointed by each member. The bank normally meets once a year.

The board of governors delegates most of its powers to a board of executive directors. Six executive directors are appointed by the six largest stockholders. The other executive directors are elected by the governors of the remaining member nations for two-year terms. Each executive director is entitled to cast the number of votes of the member or members by which he was appointed or elected. Each member country is entitled to 250 votes, plus 1 vote for each share of capital stock held.

The president of the bank is ex officio chairman of the board of
The chief executive officer of the bank. Subject to their general direction on questions of policy, he is responsible for the conduct of the business of the bank and for the organization of its staff. By the end of 1971 the bank's operating staff consisted of nearly 3,000 persons representing about 90 different nationalities.

The first president of the bank was Eugene Meyer, who held office from June 1946 to December 1949. His successors were John J. McCloy (March 1947 to June 1949); Eugene R. Black (July 1949 to December 1962); and George D. Woods (January 1963 to March 1968). Robert S. McNamara became president of the bank on April 1, 1968.

International Development Association.—In September 1960 the bank established the International Development Association (IDA) as an affiliate. The IDA is legally and financially distinct from the bank. Its articles of agreement, however, provide that countries must be members of the bank to be eligible for membership in the IDA. In addition, the president of the bank serves ex officio as the IDA's president and as chairman of its board of directors. Similarly, governors and executive directors of the bank are ex officio governors and executive directors of the IDA if the countries which they represent are members of both institutions. The bank and the IDA also have the same staff.

The IDA finances the same general type of projects as the bank, selected in accordance with common standards, but on terms that bear less heavily on the balance of payments of the borrowing country. At the end of 1971, the IDA had 107 members. Its assistance, in the main, has been confined to countries where per capita incomes are very low and that cannot meet all their external capital requirements on the basis of borrowing on commercial terms. Development credits extended by the IDA have generally been for a term of 50 years, with a 10-year grace period and no interest charge, only a service charge of 1/4 of 1%.

Most of the IDA's lending resources have come from the subscriptions and supplementary contributions of member countries, chiefly the 18 wealthiest. The bank has made grants to the IDA out of its own net income; in addition, the IDA has a small net income of its own. Part of its resources have also come in the form of an interest-free loan from Switzerland.

By the end of 1971, the IDA had extended over 280 credits totaling the equivalent of about $3,500,000,000 to 58 countries, including 122 to those in Africa, 121 in Asia, 10 in Europe, and 30 in Latin America. See also INTERNATIONAL MONETARY FUND; UNITED NATIONS: Economic and Social Cooperation; Free Trade: Bilateral Commercial Treaties; Pan-American Conferences: Ninth International Conference of American States: Economic Matters; International Finance Corporation.


BANK HOLIDAYS, in the United Kingdom, are those days which by the Bank Holidays Act of 1871 and a supplementary act of 1875 are observed as holidays in all banks in England, Wales, Northern Ireland, and Scotland. They are not statutory public holidays; their observance, however, is no longer limited to banks. Before 1830, the Bank of England closed on approximately 40 saints' days and anniversaries; but in that year the number was reduced to 18 days. In 1834 they were further reduced to four—Good Friday, May 1, Nov. 1, and Christmas Day. By the act of 1871, the following were constituted bank holidays in England, Wales, and Ireland: Easter Monday, the Monday in Whitweek, the first Monday of August, Dec. 26 if a weekday and, by the act of 1875, Dec. 27 when Dec. 26 falls on a Sunday; and by the Bank Holiday (Ireland) Act, 1903, March 17, St. Patrick's Day (or, if that is a Sunday, the next following day) as a bank holiday for Ireland. In England, Wales, and Northern Ireland, Christmas Day and Good Friday are bank holidays under common law. In Scotland, New Year's Day, Christmas Day, Good Friday, the first Monday of May, the first Monday of August or, if Christmas Day and New Year's Day fall on a Sunday, the next Monday following are bank holidays under the act of 1871. The same act made it lawful for any day to be officially proclaimed a bank holiday throughout the United Kingdom. In Northern Ireland it has become customary for July 12 (the anniversary of the Battle of the Boyne, 1690) to be appointed a bank holiday. In the middle and late 1960s the government changed the Whitsun and August bank holidays as an experiment to alleviate holiday congestion. The Late Spring Bank Holiday (formerly Whit Monday and the Summer Bank Holiday (formerly August Bank Holiday) were moved to the Mondays nearest May 31 and August 31, respectively.

BANKING. In this general survey of banking, several aspects of the subject are examined separately. In a discussion of banking it is essential at the outset to distinguish between commercial banks and central banks. Central banks may be viewed as "bankers' banks." They are lenders of last resort to the commercial banks; they regulate the monetary and credit conditions of the countries in which they operate; they act as banks and fiscal agents to governments; and, usually, they have a monopoly of the note issue. In the exercise of their function as lenders to banks and to governments, they create credit and thus fulfill the essential function of a bank. In many countries they serve both as central banks and as commercial banks.

(A. E. B.)

A modern commercial bank provides a wide variety of services to its customers, savings and deposits. It may maintain a vault with individual safe-deposit boxes available to its customers on a rental basis, and it may serve as an administrator of trust funds. A commercial bank may also offer a broad range of other services such as the purchase of travel tickets, the disbursement of dividend payments for corporations and the payment of amounts due on behalf of its customers. These activities impose great responsibilities on banks and require highly developed skills; but they involve relatively little theoretical analysis.

The commercial bank, in its characteristic role, makes loans, accepts deposits and provides a means of payment by the transfer of deposits from one account to another. Its most distinctive feature, however, is its power to create credit and thus add to the money supply by lending sums larger than the sums deposited with it in actual cash. To describe and define a commercial bank as a bank that has the distinctive power to create money and credit excludes from this category a number of institutions frequently referred to as banks. Such a definition excludes savings banks (q.v.), investment banks (see INVESTMENT BANKING), trust companies (see TRUST COMPANY) and other institutions in the financial field that lack the power to create credit. Institutions of this latter type are not discussed here apart from incidental reference.

I. HISTORY OF BANKING

There exists little historical evidence as to the nature of banking operations before the 13th century. For the earlier period, the distinction between commercial banks and other types of banks is difficult to make with certainty. As A. P. Usher points out, it is very difficult in this early period to differentiate between the activities of dealers in coin and in bullion and the activities of banks. Money changers and bankers were often viewed as one and the same. Although there are very early records of loans and of deposits it does not follow that they constitute evidence of banking activity in the sense in which we have defined it. Such early transactions may not have involved the creation of credit but may well have been limited to the acceptance of deposits and the making of loans. Thus what follows must be read in the light of these views and in the light of the commonly held opinion that commercial banking evolved only in the later medieval period from the much older functions of money-lending and money-changing. Central banking is of comparatively recent origin.

A. ANCIENT AND MEDIEVAL WORLD

There are records of loans by the temples of Babylon as early as 2000 B.C. As temples were considered sacred places under the special protection of the gods, they were not likely to be robbed, and thus were considered safe depositories. Companies of traders