THIS FILE IS CLOSED AS OF
DECEMBER 1965.
FOR FURTHER CORRESPONDENCE SEE:

RECORDS MANAGEMENT SECTION
February 1969
DATE AND TIME OF CABLE: DECEMBER 23, 1965 5:15 PM
LOG NO.: TELEX - DEC. 23
TO: INTRAFRAD
FROM: PARIS

TEXT:

659 FOR MRS. BOSKEY

COMMITTEE'S DECISION ON HOROWITZ "COMMITTEE WILL FIRST, KEEP THIS ITEM ON ITS AGENDA SECOND, REQUEST SECRETARY GENERAL UNCTAD APPOINT AFTER CONSULTATION WITH GOVERNMENTS PERSONS WITH SPECIAL EXPERIENCE IN FIELD OF FINANCING AND BANKING TO SERVE IN PERSONAL CAPACITIES AS MEMBERS OF A SPECIAL GROUP. TASK OF GROUP WOULD BE TO CONSIDER ECONOMIC AND FINANCIAL PROBLEMS INVOLVED IN HOROWITZ PROPOSAL AND SIMILAR SCHEMES AND POSSIBLE VARIATIONS INCLUDING CONSEQUENCES THEY MIGHT HAVE ON OTHER METHODS OF BRINGING ABOUT TRANSFER OF REAL RESOURCES ON CONCESSIONAL TERMS TO DEVELOPING COUNTRIES. IN SO DOING GROUP WILL GIVE DUE REGARD TO ANALYSIS IN IBRD STAFF STUDY OF HOROWITZ PROPOSAL. SECRETARY GENERAL UNCTAD WILL INFORM COMMITTEE ON PROGRESS OF THIS WORK AT ITS NEXT REGULAR SESSION" SENDING REPORT BY LETTER REGARDS

KARASZ

FOR INFORMATION REGARDING CABLES, PLEASE CALL THE COMMUNICATIONS UNIT EXT. 2021
December 3, 1965

Dear Mr. Taub:

We were glad to receive two copies each of the English, French and Spanish versions of the booklet "The Horowitz Proposal". I have made copies available to Mr. Woods and Mr. Demuth, which copies will also form a permanent part of our library on this subject.

Inasmuch as we shall probably receive requests for additional copies, do you prefer that such requests be referred to you or to send us additional copies to make available.

Best regards.

Sincerely,

M. M. Mendels
Secretary

Mr. Y. J. Taub
Secretary General (Acting)
Bank of Israel
Jerusalem, Israel
October 8, 1965

Mr. Y. J. Taub
Secretary General
Bank of Israel
Jerusalem
Israel

Dear Mr. Taub:

I am replying to your letter of September 29, asking about the possible inclusion of the minutes of Governor Horowitz' address to the Bank's Executive Directors at their informal meeting last June 24 in a set of selected documents that may be published on the Horowitz Proposal.

We are happy to make available the full transcript of Governor Horowitz' statement to the Executive Directors for use in any way that he feels would be helpful, and we enclose this material which had the benefit of Governor Horowitz' review before being issued.

However, we do not feel that the statements made by the Executive Directors can be released for publication. We believe that such release of their comments would violate the strict confidentiality which has always applied to the opinions of Executive Directors on matters before them and would have the effect of limiting participation on future similar occasions.

In addition, any plan to release such proceedings would require the prior permission of the Executive Directors concerned. It is entirely possible that in some cases such permission might not be forthcoming, thereby making possible only an undesirable partial release. As to reporting the Directors' statements without identification, we believe that this would run the risk of the sources somehow becoming known.

As you know, Governor Horowitz, in his address, ably covered the ground to which the Executive Directors returned in their subsequent comments and we hope that, in this respect, the transcript of his own statement will prove to be sufficient to your purposes.

Yours sincerely,

[Signature]
M. M. Mendels
Secretary
I am returning to your letter of September 20, without any comment.

Sec. Y. T.strup
Secretary General
Bank of Israel
Jerusalem
Israel

Dear Mr. Tenzin

I am responding to your letter of September 20, without any comment. It is my understanding that the Secretary General of the Monetary Committee of European Economic Cooperation has been visited by the Governor of the Bank's Executive Division of their recent meeting. I am pleased to say that a set of selected assurances were made by the Governor's representative.

I am happy to make available the full transcript of the Governor's statement to the European Division for your use in a way that may be helpful in your discussions with the Secretariat of the European Economic Cooperation. I am sure that the transcript will be of assistance in your deliberations with the European Economic Cooperation.

However, I do not feel that the transcript may be of assistance in the European Economic Cooperation.

In addition, we plan to release and broadcast the transcript.

I am sure that you will agree that the transcript may be of assistance to the European Economic Cooperation.

Yours sincerely,

[Signature]

M. M. Kentfield
Secretary
Fullerton, Mackenzie & Associates Ltd.
Ottawa, Canada

Letter of thanks for copy of "The Horowitz Proposal"

Date: August 4, 1965

Referred to: Mr. Farinham
Date received: August 9, 1965
DATE OF WIRE: JULY 18, 1965
LOG NO.: ITT 14
TO: MENDELS INTEAFRAD
FROM: JERUSALEM

TEXT:

CORRECTIONS MY STATEMENT PAGE THREE LINE TWENTYTHREE SHOULD READ "THE PROBLEM WAS SIMILAR TO THAT OF PREVENTING THE REPERATION OF THE 1929 TRAGEDY" PAGE SEVEN LINE THREE "HE ALWAYS WANTED SAFETY. THE HIGHEST RETURN AND THE POSSIBILITY OF GETTING THE PAPER ON THE MARKET AND THE SAME APPLIES TO OTHER INVESTORS" PAGE EIGHT LINE THIRTYONE "WORKING CLASSES IN 19TH CENTURY" LINE THIRTYSEX DELETE "TOO REVOLUTIONARY".

HOROWITZ

AS RECEIVED

EGC
Dear Mr. Nelson,

Thank you very much for your letter of June 7, 1965, in which you sent along a copy of the Bank's study on the Horowitz Proposal.

I hope that you can visit us in July and I am looking forward to seeing you.

With best personal regards.

Yours sincerely,

W.G. Demas
Head, Economic Planning Division, Office of the Prime Minister.

Mr. Roger Nelson,
Western Hemisphere Department,
International Bank for Reconstruction and Development,
1818 H Street, N.W.,
Washington, D.C. 20433,
U.S.A.
ECONOMIC PLANNING DIVISION
Office of the Prime Minister
Windmill
Maraval Road
Port-of-Spain
Trinidad and Tobago

Dear Mr. Keiron,

Thank you very much for your letter of June 7, 1969, in which you request a copy of the Bank’s study on the hydroelectric project.

I hope that you can assist me in this matter and I am looking forward to seeing you.

With best personal regards,

Yours sincerely,

W.G. Dennis
Head, Economic Planning Division
Office of the Prime Minister

MT. Robert Keiron
Department of International Bank for Reconstruction
and Development

1969 DON 1 FM 3 22
Whittaker
150433
1318.

RECEIVED
COMMUNICATIONS
GENERAL FILES
RECEIVED
June 7, 1965

Dear Mr. Demas:

In response to your request in Mexico City, I am enclosing a copy of the Bank staff study on The Horowitz Proposal. A new Bank-Fund publication, Finance and Development, has just been published and I have asked our Office of Information to send you a sample copy, together with a form to arrange for regular receipt of the publication. I hope that these publications will be of interest to you.

It was a pleasure to meet you in Mexico City and to have the first opportunity to talk with you about economic prospects of Trinidad and Tobago and the work of the Planning Office. I am hoping very much to see you again during July. Prospects are that I will be visiting Trinidad and Tobago for a week or two. When the schedule is more definite I will get in touch with you to arrange for a meeting.

With best personal regards.

Sincerely yours,

Roger Nelson
Western Hemisphere Department

Enclosure

Mr. William G. Demas
Head, Planning Division
Office of Prime Minister
Whitehall
Port of Spain, Trinidad
Trinidad and Tobago

RSNelson/jim

cc: Mrs. Eliason
FROM: The Secretary

July 19, 1965

STATEMENT BY GOVERNOR HOROWITZ - JUNE 24, 1965

Attached, for the information of the Executive Directors, are notes on Governor Horowitz's presentation, made to the Directors on June 24, 1965, of the proposal he submitted to UNCTAD.

Distribution:

Executive Directors and Alternates
President
President's Council
Executive Vice President (IFC)
Department Heads (Bank and IFC)
1. Mr. Woods welcomed Governor Horowitz, commenting that the Governor was appearing not as the Governor of the Bank of Israel or as the Governor of the International Bank representing Israel, but in the capacity of the author of a proposal submitted to the first United Nations Conference on Trade and Development. The Conference had asked the Bank to study and report on the proposal, and a report prepared by the Bank staff, entitled "The Horowitz Proposal", had been sent to the Secretary General of the United Nations in February. It would be considered in the fall by one of the committees recently set up by the Trade and Development Board. Governor Horowitz had told Mr. Woods that he would like to present his proposal to the Executive Directors of the Bank in person, and it was agreed that he should do so. Governor Horowitz's presence in Washington for negotiations on the pending loan to the Industrial Development Bank of Israel provided an appropriate opportunity for his presentation.

2. Governor Horowitz, after expressing his appreciation for the opportunity to present his plan, made two preliminary comments. First, although the Government of Israel fully endorsed the proposal as a solution to a problem of wide general concern, Israel was not directly interested in it from an economic point of view; that is, it did not expect to benefit in any way should the proposal be implemented. Second, the provisions of the proposal should not be considered rigid and unchangeable. The basic idea was subject to modification and change not only in the course of formulation but in the course of implementation, should it be put into effect. It dealt with the critical problem of the twentieth century: the financing of the development of underdeveloped nations.

3. Several theses underlay the proposal. First, with prevailing methods and on present terms of lending, the financing of an economic break-through in the underdeveloped world was impossible. Second, this enormous task could nevertheless be accomplished with modern technology and economics. Third, on the present basis of financing, the flow of funds tended toward equilibrium; at some point, funds going out as assistance and funds coming back as repayments would be about equal, effectively nullifying the ability of the financial aid to advance development. Fourth, a program of lending on terms which would make possible an economic break-through could not be based on budgetary allocations by governments, requiring ratification by legislatures. Finally, a vast transfer of capital, starting on a small scale and then expanded on the basis of his proposal, would benefit not only the underdeveloped world, but the developed countries as well.

4. Governor Horowitz said he had proposed a new technique; new ideas were necessary at the present cross-roads of history. Humanity and the world economy were faced with three basic disparities. The first was the
disparity in living standards, which were something like 1 to 40 to 1 to 50, an intolerable gap. The second was the disparity between the political independence and power of the underdeveloped nations, which had achieved a standing and influence in world affairs unprecedented for these countries, and their economic situation. The third was the disparity between the challenge and the performance.

5. To a considerable extent, the ferment in the underdeveloped world could be attributed to the disparity between living standards of developed and underdeveloped nations, a disparity which was brought home and emphasized through modern communications media: television, radio, the shiny car passing through the village in India or Egypt. This "demonstration effect" reinforced the unrest in the developing countries. Deterioration was inevitable on the present basis; time was running out. The situation demanded vision transcending technicalities; it called for a sense of history and statesmanship.

6. The development of the developing nations could not be achieved by gradual and slow infiltration of capital. A slow and gradual infiltration of capital would achieve no more than some fostering of primary production for world markets. But the prices of primary products were already depressed and, with the development of synthetic materials and for other reasons, there was already an over-production in this area. A breakthrough in economic development could not be achieved by the process of infiltration; it was possible only with immense transfers of capital, which would create a domestic market as a catalyst for the diversification of the economy, leading to a rise in the standard of living. In general, it was impossible at present to develop an economy, particularly one based on primary commodities, only by encouraging production of export products. Diversification, for which development of an internal market was essential, could be achieved only by an economic breakthrough, on the basis of vast capital transfers, accomplished within a relatively short period. That was the experience of Israel. Israel lacked natural resources; it had no coal, no oil, no timber. Yet it had achieved a remarkable growth of GNP -- 10% per annum for 16 years -- by the creation of an internal market which stimulated production, enabled diversification of the economy and created the technical and economic minima which were a necessity for each enterprise. The Horowitz proposal thus started from the premise that a gradual, slow development had little prospect.

7. The only criterion of success or failure in economic development was the growth of per capita GNP. The Director of the Economic Development Institute, in a talk reproduced in a Bank pamphlet, "The Progress of Economic Development," made the point that to evaluate the real effect of an economic growth rate it was necessary to relate that rate to the population growth. Where the growth rate was 4% and the population growth something like 2%, perhaps a bit higher, the rate of growth of per
capita income was about 1 1/2%. One approach to the question whether that per capita growth rate was adequate was to consider how long it would take for a family, or other group, to double its income. Compound interest tables would indicate that it would require approximately 70 years to double a 1% rate. Translating this example into the context of the situation in less developed countries, Governor Horowitz commented that in most of these per capita income was no more than $60 to $100. The prospect of waiting for 70 years to reach a level of $120 to $200 per head in these countries seemed a frightening vision. The pamphlet went on to note that in a number of countries agricultural production per capita was below the level of 10 or 15 years earlier and that, while in the last 20 years world trade had expanded at an unprecedented rate, most of the expansion had taken place in trade among the advanced countries, and from the advanced countries to under-developed countries. Exports from the underdeveloped countries had not significantly risen, and some of those countries would, in the coming years, have to set aside something like 25% to 30% of their foreign exchange earnings to meet their debt service obligations. Governor Horowitz said that the Bank was, properly, an optimistic institution; optimism was necessary for progress. But recognition of the facts was a first step toward remedying the situation, and the facts to some extent supported his argument that what was needed was a sense of history, not of routine. The problem was similar to that of preventing the repetition of the 1929 tragedy which, it was now known, could have been averted were it not for obsolete thinking and lack of statesmanship. The status quo was intolerable.

8. The introduction of the Secretary-General's Progress Report on the United Nations Development Decade stated that the progress thus far achieved toward the objectives of the Decade was less impressive than the fact that those objectives, although not very ambitious, remained quite distant, that many of the proposals for action put forward by the Secretary-General in 1962 had hardly begun to be translated into reality and that hopes for increased resources underlying some of the proposals had not yet materialized.

9. Economic growth could be accelerated in the less developed countries in either of two ways, by capital formation or capital input. Modern Western economies were developed by capital formation -- squeezing out the last ounce of effort and cruelly depressing living standards. There was at the time no alternative, because no other part of the world could provide capital. But to adopt that approach in the underdeveloped world today would be very difficult. There was little to be squeezed out, since per capita income was already so low -- from $60 to $100. It would be socially and politically difficult, as well, and could be achieved only under an authoritarian and totalitarian regime. There was, however, an alternative in the world of today. One-third of the world was highly developed, and the desired result could be achieved, with modest capital
formation in the underdeveloped nations, by a transfer of capital which the developed part of the world had the capacity to supply. The problem was not only economic, but to a very great extent political as well. The underdeveloped world was a no-man's land between ideological blocs, a promising area for conflict -- political, economic, and ultimately military. The stakes were high. With modern technology and modern economics, it was possible to deal with the problem without serious economic sacrifice by any part of the world. The essential precondition was that, in the international arena, there should be no repetition of the mistake made in 1929 in the national arena. That mistake lay in analyzing the problem in terms of the financial facade, without considering the real resources. In 1929, taxes were increased, budgets were balanced, expenditure was cut. Today it was realized that a recession could be prevented by doing just the opposite, and by dealing with real economic processes.

10. The World Bank, Governor Horowitz said, was not an objective in itself. It was a chosen instrument for dealing with the problems of development. If it did not effectively contribute to a substantial increase of the GNP of the underdeveloped world, it would have failed in its objective, even though as an institution it proved to be as efficient as a Swiss clock. Its success was to be measured by the results achieved in the underdeveloped countries.

11. Economic assistance was decelerating. The OECD had just published a report indicating that the flow of funds to the developing world from all sources amounted in 1961 to $9.22 billion, in 1962 to $8.476 billion, and in 1963 to $8.486 billion. At best, this indicated that a plateau had been reached. In fact, there was a severe decline, much more pronounced than the figures suggested. The drop of $1 billion was in itself a substantial decrease, but even had there been no falling-off in the absolute amount, there would have been in effect a decline: during the period the population in the developing nations had increased by 6%, and the real criterion was the input of capital per head. Moreover, during the three years in question, the prices of manufactured products purchased by the developing nations had increased substantially. Finally, in those years the GNP of the developed world had increased by at least 10% in real terms. Consequently, viewed as a percentage of GNP of the developed world, the flow of external resources had severely declined. When Governor Horowitz had referred to the need for an immense transfer of capital, he meant an immense transfer in terms of the developing nations, not of the developed countries. Only something of the order of 1-1/2% to 2% of the GNP of the latter was involved. During the war, 25-30% of GNP was dedicated to the war effort. Nothing like that was being suggested.

12. The technique of pump-priming, to keep up demand and prevent a recession, was known and used in internal markets of the developed countries. There was an analogy, economically, between domestic pump-priming
and assistance to developing countries. It would be to the benefit of the developed nations, which now dedicated to assistance less than 1% of their GNP, to accelerate their aid. Besides, if they did not, within the not too distant future a point of equilibrium would be reached between repayments and assistance -- a peak of respectability and a peak of futility at the same time.

13. Since the Horowitz proposal was submitted, a report had appeared, which Governor Horowitz recommended to everyone interested in development, a report published by the AID on the problem of indebtedness. That report completely vindicated what he had said in the forum of the Board of Governors some five years earlier and later at UNCTAD. Mr. Woods commented that the report had been digested and circulated to the Executive Directors, and he thought it likely that many Directors had obtained a copy of the report itself and had studied it further. The report stated that "In the last ten years, the debt service burden has increased so rapidly that it has cancelled out much of the growth in total aid. In 1955, 8% of external assistance receipts were offset by debt service; in 1964, debt service offset 30% of external assistance..." The report demonstrated that if all aid were extended on conventional terms, economic growth could not be achieved. Aid would not only be very expensive, but the point of equilibrium, to which he had referred, would be reached. Charts in the report showed that cheap, effective aid could be extended only on IDA terms.

14. It was interesting to note the extent to which psychological, political, and sociological elements determined something which was illogical, irrational and which ran counter to all economic reason. The Marshall Plan, one of the most successful ventures in economic life in the world, consisted of 80% grants and 20% loans. Looking back, almost everybody would very likely regard it as a mistake because the same effect could have been achieved with a larger proportion of loans and less grants. With the present situation of the U.S. balance of payments, repayments would come in handy now, and the recipients of Marshall Plan aid could now well afford to repay. In the developing nations, the reverse was being done; aid was composed of about 80% loans and 20% grants. There was a limit to the developing countries' capacity to repay commercial loans. A high interest rate had the consequence, among others, of reducing the scope of assistance.

15. That suggested that more public money was needed. Yet every one of the prominent government officials with whom Governor Horowitz had talked had said that the trend of thinking was in the direction of deceleration of assistance. Assistance was not popular. It was not popular even with governments, and it was less so with parliaments and congresses; reductions were going to be more and more pronounced. Immediately after the war, there was a tremendous flow of assistance even though some donor countries were in a difficult position, yet today the
developed countries were not prepared to devote even 1 1/2% or 2% of their GNP to assistance. An affluent society had another atmosphere, and tended to cut aid more and more, although economically that made no sense and was illogical. The Horowitz proposal therefore proceeded from the assumption that beyond a certain level a marked increase of assistance, through budgetary allocations, could not be expected. That was a very conservative statement, because what really could be expected was a cut, or at best stabilization; in any event, not an increase.

16. Some other way must therefore be found. Of course the Horowitz proposal required the consent of governments. A plan which involved government guarantees obviously required governmental consent. If the governments of the developed nations were not ready to support the plan, it would never materialize. The necessity for governmental support was, in his view, over-emphasized in the Bank staff report since that condition was inherent in the proposal itself.

17. It had been suggested that Governor Horowitz should himself go to governments and to banks of America and Europe to try to raise the capital. But that was not his job and, besides, he did not have the requisite power or influence. He could, however, try to convince the Bank, the chosen instrument of the developed world, to accept the proposal; then, he believed, governments would be convinced. The proposal could direct a tremendous flow of capital to the underdeveloped nations.

18. He had suggested that $3 billion might be raised over five years, as a start. That would double the resources of IDA. If it were said that it was impossible to raise that amount, he would reply, first, that the problem was not a static one. The Bank was in effect being asked to change the situation. In 1951, he and the Finance Minister of Israel came to the United States with the idea of issuing bonds on the U.S. market. Some two dozen bankers were consulted; each said that if $10 million could be raised in two or three years, that would be a tremendous achievement. One, who now held a central position in the United States, said, "I would have a go at it." Israel was a country of 2 1/2 million; in the years in which the bonds were issued, the average was only 1 1/4 million. The country was under siege, with no natural resources. It was a very difficult situation. No one knew whether the new state would be viable. Yet $750 million of bonds were sold. Of course there was some sentimental support for them. The current proposal, if properly presented, could have some such support, too, although not to the same extent. On the other hand, powerful nations were members of the Bank, whereas Israel had been a new, poor country and no one knew whether it would survive.

19. In Governor Horowitz's opinion, any amount of money could be obtained in world financial markets, given the essential conditions of collateral, safety, interest rate, and priority in the market. On
this point Governor Horowitz spoke from his own experience. He was by profession a practical banker with some experience, not unsuccessful. He had placed some \$650 million of Israel’s reserves. He always wanted safety, the highest return, and the possibility of getting the paper on the market and the same applied to other investors. There was no such thing as inability to raise money. It was true that other paper might be displaced. In the context of the proposal, that would not matter. The objective of the proposal had a very high priority.

20. The table on page 27 of the Bank staff report showed that if \$3 billion were raised, in the fifth year the interest equalization fund would reach a peak of \$120 million. This \$120 million would have no significance whatsoever for the balance of payments, because it would be paid over to bondholders in the developed nations themselves. If the \$50 million of Bank net earnings transferred to IDA could be applied to the equalization fund, only \$70 million would remain to be contributed by the whole developed world. Even if that amount were to be deducted from grants-in-aid, it would be worthwhile, to enable the \$3 billion to be raised. Perhaps \$35 million might be provided by the United States and \$35 million by the other developed countries. This was the principle of the multiplier, the ignition spark, which could release an immense volume of energy.

21. A guarantee provided as collateral by the whole developed world would mean, first of all, that the obligation would be spread over a very wide area. Secondly, it would be a contingent liability. If the operation were successful, as should be assumed, the liability would never materialize or at worst would materialize to a very small extent after many years. Moreover, it would be easier to go to parliaments and say, “We are going to raise money through the private financial markets. What we want from you is a small amount.” This approach would circumvent most of the difficulties, which were mainly political and psychological. The proposal contemplated that the bonds would be issued by the Bank and that the Bank’s loan to IDA would be guaranteed by the developed world, so that the Bank would be completely protected. Supposing that even under these conditions it were necessary, in order to raise \$3 billion, to add another percentage point over the Bank’s normal rate of interest, that would add only another \$30 million to the amount to be contributed, by the whole developed world, to the interest equalization fund. Thirty million dollars was a significant sum, but not in relation to the effect which could be achieved.

22. There was really no balance of payments problem with respect to principal. Taking the OECD table of aid according to countries, aid contributions appeared in inverse ratio to the balance of payments: most of the money was contributed by countries which had a balance of payments deficit. Under the Horowitz plan it would be possible to some extent -- not one hundred percent, perhaps not even fifty percent, but to some extent -- to take into consideration the balance of payments
problem. This could be done by having issues mainly in the markets of countries which had a balance of payments surplus. "Mainly", not completely, because countries which had a balance of payments surplus did not always have a highly developed capital market. It should also be noted that the United States permitted borrowings by and loans to the developing nations in spite of its balance of payments problem.

23. The $600 million a year, or $3 billion over five years, contemplated by the proposal was only 1/20 of 1% of the GNP of the developed nations, which was increasing at a very rapid pace. At present, the GNP of the developed nations was about $1,050 billion; in five years, by the end of the decade, it would be $1,200 billion.

24. The point had been made that it might be difficult for governments to commit themselves several years in advance, even for small amounts. The solution might be to accumulate the five-year amount within two years, a period for which every government could commit itself. Grants-in-aid might even be eliminated during those two years. Since the full amount built up would not be disbursed immediately, it could be invested, with interest on the investment added to the fund.

25. There was no claim that the plan was a panacea, by means of which a tremendous and crucial problem could be solved with business as usual. It would be beneficial to both the less developed and the developed parts of the world, but it could not be said that the problem could be dealt with without the slightest dislocation. If "no dislocation" had been the guiding principle, the Bank would not have been established in the forties. The Bank's operations, after all, departed from the pure principle of financial virginity -- loans at 5 1/2% interest for 15 or 20 years were not the best possible investment.

26. The developing countries asked for preferences, and had been told "no". Requests for buffer stocks, and financial aid, produced the same answer. They tried recourse to international democracy, as the working classes in the 19th century tried national democracy. That way was blocked by a sterile approach to the whole problem. And this was in the Development Decade. There might be an alternative to the Horowitz plan, but it was not the status quo. There was in fact no alternative which he himself would support wholeheartedly. The Stamp Plan was perhaps one possibility. He thought it too radical and as a conservative banker, he did not advocate it, but it was better than the status quo. He considered his own plan preferable, as being more gradual, more conservative, more orthodox. But the Stamp Plan was better than a sterile approach to the problem.

27. A political and moral decision had to be taken. With the means at hand, with modern technology and modern economics, with the nations of the world reaching for the stars, the problem could be solved with relative ease, provided obsolete thinking, which did not conform to the realities
of the present situation and to current economics, were discarded. The Horowitz plan was a modest, small contribution to the solution of the problem and an experiment which should be tried, at least.

28. Mr. Woods, in thanking Governor Horowitz, commented that Governor Horowitz was obviously dedicated to the view that the present situation was intolerable, that his remarks had been helpful, and that he had been most generous in saying that as long as something was done, he had no particular brief for the Horowitz plan. Mr. Woods himself agreed that the status quo was not good enough.

29. Dr. Mejía-Palacio said that in general he was in accord with Governor Horowitz's presentation of the problem. In the 20's and 30's, it was thought that private capital flows to the underdeveloped countries could be the answer to the problems of those countries. That did not prove to be so. After the Second World War, it was thought that perhaps public capital on conventional terms would be the answer. Now it was realized that the time was coming when many of the underdeveloped countries could not absorb more conventional loans at a high rate of interest. There had been hopes that IDA could be the answer. But over the last five years it was realized that IDA was a very small fund, that the countries that could provide its resources were not willing to go too far, and that IDA funds had been limited to very few countries and for very few purposes. Latin America was not satisfied with IDA.

30. Dr. Mejía said his countries preference, as the first solution, was fair trade. That was the cheapest way for both the developed and underdeveloped countries to improve conditions. This was why at UNCTAD the effort was made to convince the developed countries that they must open their markets to the products of the underdeveloped countries and pay fair prices for primary products. In his own country, the foreign exchange earner was coffee. If the developed countries were willing to pay as little as one cent per cup of coffee, IDA and Bank would not be necessary. The price of sugar now was the lowest in history. For these reasons, the less developed countries were emphasizing trade. They would be glad to have the Bank or the new trade organization put more emphasis on organizing international trade, opening markets for the products of the underdeveloped countries, and establishing fair prices. If that were not possible, he agreed that massive help was necessary. It had to be massive because of the problem of population increase. The need was for much more capital, promptly. The help which countries had been receiving was simply compensating for the losses they had realized in international trade and for the population increase.

31. Dr. Mejía commented that the Bank staff report indicated that the proposal raised many questions. The Directors had not discussed the report; it had been submitted on the responsibility of the management. He agreed with Governor Horowitz that the report had given priority to the Bank's
needs for borrowed funds. Governor Horowitz had argued, in contrast, that
the Bank had now to give way to a new institution like IDA. Dr. Mejia
thought the place to go into the report was the next meeting of the Trade
Conference. His own country was following developments very carefully
and was willing to help in that meeting.

32. Mr. Suzuki noted that Governor Horowitz had suggested that $3
billion be raised in the market. Whenever capital was to be transferred,
some local currency should be raised in the recipient country. In his
own country, when foreign capital came in, there had been a local currency
addition at a rate of perhaps 4 to 1, 20% in foreign capital and 80%, per-
haps even 90%, added out of domestic resources. He wondered what Governor
Horowitz was expecting. Governor Horowitz replied that the proportion
could not be the same for all countries and that the average must be very
flexible. Under present conditions in the developing world he thought the
proper rate, without squeezing too much out of living standards, might be
about 10% of GNP. He based that on a Bank study of nineteen nations which
showed that figure to be about the factor for capital formation. This
was an average; in some nations it might be 20%, in some it would only be
2%. Assistance from the developed world, as he had already said, should
be about 1 1/2 to 2% of GNP. The higher rate for the less developed coun-
tries was for their own sake. With these amounts, the developing nations
could achieve a reasonable growth which would at least eliminate the pre-
vailing sub-human living standards.

33. Mr. Hudon commented that Governor Horowitz's statement had been
eloquent and stimulating. The staff report had pointed out the two basic
premises on which the proposal turned. One was that to achieve a satis-
factory rate of growth in developing countries considerably more capital
than was presently flowing to these countries was needed. He had no quarrel
with Governor Horowitz's conclusion that the task was immense and the
need urgent. The second premise was that it was not politically realistic
to expect development assistance on the scale and terms required to be made
available through budgetary appropriations. That was an extremely diffi-
cult judgment to pass. He could not say whether Governor Horowitz was
right or wrong on this point. But he wondered whether, taking the second
assumption, the solution proposed did not in fact avoid or try to avoid
a sense of history, although Governor Horowitz had said a sense of history
was necessary if the problem was to be solved. The proposal in a sense
offered the easy way out, making it unnecessary to face it up to the problem.
Mr. Hudon wondered whether that was really helpful in terms of reaching
the objectives.

34. One of the conditions for the success of the proposal was access
to financial markets. Mr. Hudon thought this a very difficult and com-
plex problem. It could not be dealt with by approaching first one coun-
try and then another; countries had to be approached as a group. That
alone was extremely difficult. If there were added the concept of taking
into account the balance of payments situation, it became even harder. He wondered whether, if allowance were to be made for balance of payments situations, that would not create a great deal of uncertainty as to the source and amount of the funds of whatever institution was to administer the plan. Balance of payments situations could change quite radically. A commitment made one year might have to be changed the next, and some kind of adjustment would have to be made within the group. This raised a large question mark in terms of the continuous flow of resources to the institution.

35. Mr. Hudon's second query concerned the flexibility of the amount to be raised. He wondered whether Governor Horowitz would go so far as to suggest that perhaps the plan should be instituted on an experimental basis with no large scale objectives in mind -- rather to raise a relatively modest amount and see what the real potential was and whether it was worth pursuing. Or did Governor Horowitz consider that a minimum of the order mentioned in the report must be raised?

36. Governor Horowitz replied that he did have a certain amount of pessimism concerning the readiness of parliaments and congresses to allocate aid, an attitude based on experience. He was aware of the difficulties encountered by the Bank in mobilizing funds for IDA; the result was, to say the least, inadequate. The facts and figures proved there was a deceleration of aid. He was not ready to sacrifice material effect for the moral satisfaction of having countries do the right thing, which was what he felt was the implication of Mr. Hudon's remarks. It was an interesting approach, but he feared that the material results might be minimal. If all the nations of the world were ready to provide aid on the Marshall Plan basis, he would not object. That would in fact be better than the Horowitz plan. It was quite true that his plan was an attempt at an easier approach than an appeal to parliaments. Every deviation from routine and inertia was difficult. It was always true that the easiest way was the routine way.

37. Mr. Hudon's second point, the problem of bilateralism and multilateralism, was an important one. Some of the developed nations did not like the proposal for a single reason -- it was a multilateral plan. Nevertheless, a recognition that multilateralism was to be preferred was slowly gaining ground. Senator Fulbright had said that he had never seen a sign saying "World Bank go home." For the time being, however, the multilateral approach still encountered certain difficulties. Some countries believed that political objectives could be gained by some kind of bilateralism. He himself doubted it. The multilateral approach, the approach of the Bank and IDA, was the right one.

38. Concerning the problem of flexibility of amount, Governor Horowitz said that the amount he had projected, $600 million a year for the whole developed world, was so small that it could not dislocate financial markets...
in any way. In a single year, $35 billion of fixed interest debentures, external and internal, had been floated in the developed countries. Even if only $400 million could be raised annually under the proposal, that would be acceptable. The project was small and experimental. If he had to choose between nothing and a smaller project, he would of course choose the smaller project. He wanted to make a beginning, and he was convinced that expansion would follow. Nobody thought when the Bank was established that it would reach the scope which it had today. So he was willing to start with a smaller goal.

39. Mr. Woods said there was a trend toward multilateral procedures insofar as the professionals in the aid business were concerned. He was not sure that was true with respect to either the industrialists of the capital-exporting countries or the majority of the legislatures of the capital-exporting countries. Senator Fulbright had over the years been a voice in the wilderness. In the countries that were the larger sources for Bank or IDA funds, there was still a great deal of work and education to be done on the multilateral approach. He liked to think a little progress was made each year. There would always be some bilateral assistance in any event.

40. Dr. Lieftinck said the project was exceptional. It reached the heights of intellectual ingenuity, and at the same time reached toward the ends of the earth, because it offered new thinking with respect to possible solution of one of the most urgent problems with which the world was faced. He agreed with practically everything Governor Horowitz had said about the background. Governor Horowitz had indicated that the capital needed for the implementation of the proposal was available. There were sufficient savings in the industrialized countries to increase the flow of capital toward the less developed part of the world. At least, the savings being mobilized by treasuries or otherwise made available for development purposes could be made available on different terms, not on conventional terms but on so-called IDA terms. Dr. Lieftinck had little doubt that if the more well-to-do parts of the world realized how great were the differences between their standards of living and those of the underdeveloped countries, and how great were the dangers developing for stability in the world as a result of the growing disparity, they would become more constructive in trying to find better solutions than had thus far been applied.

41. Governor Horowitz had very rightly pointed out that if development assistance were continued on present terms, which were hardening somewhat instead of softening, a point of equilibrium would be reached at which debt service would have risen so much that, with the present volume of conventional assistance, there would be no surplus inflow into the developing countries. That indicated that a more rapid development, which Governor Horowitz had so eloquently advocated, could not be achieved by continuing the present method of financing, and that another method was required, on IDA terms. Dr. Lieftinck wondered how the two problems could be solved.
at once — the one problem of increasing the total volume of assistance
and the other problem of the way on which assistance was made available.
In his opinion it was necessary that aid on conventional terms be reduced —
that is, that the burden had to be reduced, calling for a substitution of
the IDA kind of assistance for conventional assistance. That alone
would require the mobilization of considerable amounts to be made available on IDA terms. How could an increase in total volume of assistance be achieved at the same time? He wondered whether it would not be better to direct efforts toward a better composition of assistance rather than concentrating too much on an increase of total volume.

42. Dr. Lieftinck noted that the Bank staff report referred to the
possibility that governments might themselves borrow in their own capital
markets, subsidizing the interest as required, and making the borrowed
funds available on easier terms. He wondered whether, in view of the high
priority which so many governments were giving to bilateral aid for various
reasons, including balance of payment considerations, Governor Horowitz
might regard this alternative approach as perhaps more practicable and
one to be tried out first. In his own opinion, the resistance to multilateral aid was very difficult to overcome. One of the first steps in
the direction of creating a better atmosphere for suggestions like the
Horowitz proposal was to make a frontal attack on the preference for
bilateral aid. Unless that barrier was broken, he thought there was
little hope of coming to grips with the real problem, and with constructive suggestions such as Governor Horowitz's.

43. Mr. Wright commented that he had now twice had the privilege of
hearing Governor Horowitz expound his plan, particularly his premises and
the plan's background. On the first occasion he had felt the exposition
so good that it could not be improved upon, but in that he had been mistaken. His first point was essentially one made by Mr. Hudon. Governor
Horowitz had said that a significant, almost a traumatic, change in political will was required to contemplate additional soft-term aid on the scale indicated in his plan. At the same time, Governor Horowitz had said that
the question of the political will must and should be influenced by seeing the issue in terms of a shift of resources, rather than in terms of
a financial facade. But, intellectually attractive though the plan was,
it seemed to Mr. Wright that it would not be unreasonable to characterize it as simply a change in the financial facade. What was in fact being talked about was a major shift in resources along rather different lines
from the budgetary approach which was normal in the past. It seemed to
him rather odd to expect that a traumatic change in political will could be brought about by changing the financial facade. It was true that quite
a bit could be done at the margins by changing facades, financial or otherwise, but that was rather different from the revolutionary change in political will that Governor Horowitz seemed to have in mind.
Mr. Wright was not sure that he saw present prospects in quite such pessimistic terms as Governor Horowitz did, nor that he accepted the premise that the major obstacle to a very substantial increase in the flow of soft resources was in fact the viewpoints of parliaments. It was easy to become over-influenced by daily accounts of the progress of aid legislation in the U.S. Congress. But he thought that what was really at stake was competing claims on resources, political issues; the political will did exist. In his view, the figures to which Governor Horowitz had pointed might suggest a temporary plateau, rather than a trend. There were many hopeful signs. Many governments had taken or were taking steps in the direction of softer loans, and there was much discussion of possible collective approaches to softer lending.

Mr. Siglienti commented that Governor Horowitz had singled out the burden on the various industrialized countries which would be imposed by contributions to the interest equalization fund and had said this was very small. Mr. Siglienti agreed that this aspect of the plan might be the easiest to accept and that the sharing of that burden would probably not be a very serious problem. The criterion suggested for sharing the guarantee, namely, IMF quotas or Bank subscriptions, might be acceptable. However, the real burden which, in his judgment correctly, the staff report had emphasized, was the need for a commitment to open financial markets. There one was at a loss for a satisfactory criterion for sharing the burden. The balance of payments criterion had been played down by Governor Horowitz. Mr. Siglienti thought the staff correct in noting that balance of payments surpluses and market liquidity did not necessarily coincide. Often countries followed a policy regarding the opening of their markets which was not dictated by balance of payments considerations; sometimes countries opened markets although the balance of payments was in deficit and closed them when it was in surplus.

Mr. Siglienti noted that Governor Horowitz had said that any amount could be raised if the price were right. The raising of even comparatively small amounts at a very high interest rate could, in some countries, completely upset the financial market and the country's monetary policy. An easier criterion which came to mind — although he was not advocating it — was that a country should take up a commitment in relation to domestic public issues, or issues made under a government guarantee, in a given year. That is, each year a government would undertake to open its market for the proposal in a fixed proportion to all of the public issues or all the state issues plus public entity issues.

Dr. Machado said that Governor Horowitz should not be disappointed when the first reaction to a new idea was "no". Those who had to appeal for help were accustomed to hear "no" as the first word in the vocabulary of the modern world. His own experience as an Executive Director was that it normally took four years for any new idea to begin to be generally accepted; Governor Horowitz therefore still had three years to go.
In terms of timing, Governor Horowitz might be luckier than were those concerned with the other experiments -- the Fund, the Bank, IDA and IFC. The basic products of Latin America were being priced out of the market: coffee was one-half of what it was worth at the time of the first UNCTAD meeting, sugar was at an all-time low, cocoa was not only a Latin American but an international commodity problem, bananas were down to the lowest they had been in years, the outlook for cotton was very dark and prices of practically all primary products were completely out of line, not even covering the cost of production. Latin American countries were plagued by inflation, and unable to meet their commitments on outstanding loans, with even the largest countries having to appeal to their creditors for assistance in spreading commitments. He thought that when the Horowitz proposal was considered in November, unless the situation had changed, the general "ambiente" would be more receptive to any idea of any kind, and the Horowitz plan was a very good one, which should be explored.

48. The problems of developing countries, Dr. Machado said, were not only confined to financial assistance. Insufficient attention was being given to the very basic problem of enabling developing countries to stand on their own feet economically. Continuing to invest in agriculture to increase production, and by so doing increasing the surplus of commodities would make the situation worse. The problem had to be faced from all sides, and other international agencies ought to realize their responsibilities in their own fields. Otherwise, little headway would be made. The underdeveloped countries had given a great deal of study to the ingenious Horowitz plan. They were in sympathy with its objectives and were sure that something would come out of the discussions in November.

49. Dr. Chen joined his colleagues in complimenting Governor Horowitz on his eloquent and masterly presentation. He believed most of them would agree that there was an urgent need to mobilize resources for the underdeveloped countries. He noted the reference in the staff report on the Horowitz proposal to a proposal made by the United Kingdom and Sweden, suggesting the provision of supplementary funds to IDA to enable IDA to engage in financing for special purposes. He would like to know whether there was any similarity between that proposal and Governor Horowitz's plan, and what were the specific objectives of the plans. Mr. Friedman replied that the plans were not really similar. Governor Horowitz's was a plan for financing an increase in IDA-type funds. The U.K.-Swedish proposal tried to deal with the problem of the consequences for economic development of an unexpected decline in export earnings. The expectation was that the staff report on the latter proposal would be completed and given to the Executive Directors before very long. When the U.N. Trade and Development Board considered the Horowitz proposal in November, it would almost certainly have before it a report on the U.K.-Swedish proposal.

50. Mr. Larre said he had found Governor Horowitz's statement very
stimulating. Three questions occurred to him. The first one concerned the possibility of raising money, in view of the Bank's recent experiences in borrowing outside of the United States. His second question related to the servicing of the volume of aid contemplated by Governor Horowitz. It would be difficult for the aid-giving countries both to ease the servicing of already contracted debt and to agree to increase their aid for the future. Finally, he questioned whether it would be easy or even possible to invest large amounts of money over a very short period in the underdeveloped countries. A little more could be invested in one country or in the developing countries as a whole at the same time, but it was not possible to move from one range to another range of amount without disturbing monetary and economic equilibrium. His comments did not mean that he thought the proposal lacked merit; they did mean that he agreed with Governor Horowitz that flexibility was needed.

51. Mr. Hirschtritt said he felt that Governor Horowitz had spoken both with heart and head. One of the key problems was that in transferring resources from the developed to the developing countries, it was necessary to proceed in such a way that the international credit structure was protected. That meant transfers on easy repayment terms; to do otherwise was to invite chaos. The question was not whether the Horowitz plan was the easier way; it was rather a question of whether it was the better way or an alternative way, whether there should be a move in the direction suggested at all, and if so to what degree. It was necessary to study the proposal as Governor Horowitz had presented it, with heart and head.

52. Governor Horowitz said that the comments he had received from the persons with whom he had discussed his plan were all encouraging; they considered the thinking behind the plan to be sound. Concerning the question raised by Mr. Larre, whether large amounts of capital could be absorbed in a short period, Governor Horowitz had very strong views, based both on his own experience and on the history of development. In no country had development succeeded by infiltration, by stretched-out assistance. It was much easier to achieve it in a short time, with large amounts, although admittedly this would involve a certain amount of waste. As he had already said, Israel had increased its GNP by 10% per annum for 16 years. Coverage of imports by exports rose from 14% to 55%. The locally produced supply of foodstuffs rose from 50% for one million of population, to 85% for 2 1/2 million population, and at a much higher standard of nutrition. This was done by a rapid breakthrough. If it had started with a small infiltration of capital, it would have failed. Taiwan and Puerto Rico offered other examples of development achieved by a massive transfer of funds in a short period. Of course there was a certain amount of waste -- he did not deny it. But it could not be done otherwise. Paradoxical though it might seem, an attempt to do it in a gradual way would not work at all. What was essential was the take-off, the molecular process in the economy which created a new dimension, a new dynamic where self-sustaining growth was reached, where progress was made on a very broad front -- agricultural
and industrial development, health, education -- everything together. Then there was a reciprocal interactivity. Simply to try to produce more cocoa, more coffee, and so on, would not advance development very far. It was paradoxical, but empirical experience substantiated a theoretical analysis which he did not have the time to expound. Development could be achieved in the conditions of the twentieth century only by creating an internal market and diversified economy. And that was also his reply to the Directors who had rightly stressed the point of declining prices of primary products. He was a bit pessimistic about the prospects of stopping the decline. A market economy had advantages that should not be given up. But in a market economy, it was not possible to create artificial prices. If they were created, production was stimulated and prices declined. The only solution for these countries was, in his opinion, diversification. It was not possible to diversify without investment, and there could be no investment without capital. And the capital must be on terms which could be tolerated. Preferences for primary products were palliatives. In the last resort, the solution must be diversification and industrialization, and that could not be accomplished without capital.

53. Concerning the problems raised by Dr. Lieftinck, Governor Horowitz said he thought that IDA should have a priority. It should not be said, as the staff report did say, that money could not be borrowed for IDA because then there would be less available for the Bank. Even if it were true, he would accept such a shift; methods had to change with changing circumstances. The merits of the case were more important at the moment.

54. As to the total results, Governor Horowitz said there could not be a specific ceiling; he thought 1-1/2 to 2% of the developed countries' GNP was about right. The ceiling was a matter of political and moral decision. Once the decision was taken, then the easiest method to implement it must be found. Volume was one subject of decision and method was the other. The ceiling he had proposed was very modest. 1-1/2% to 2% of GNP, which would be very nearly $1200 billion in 1970, was by all criteria -- Marshall Plan aid, the war effort, space and armament expenditures -- a negligible amount. If that amount could be provided, it would give a tremendous push to development.

55. As to bilateral and multilateral aid, Governor Horowitz said he would not rule out bilateral aid. The point was that something additional was needed now, not a shift from bilateral but on top of it.

56. The reason Governor Horowitz thought his method was easier was simply that legislative bodies did not like to allocate budgetary funds. In the final resort, it was true that the result, as far as resources were concerned, would be the same. Governments would have to allow a bond issue, to allocate a negligible amount for the interest equalization fund and agree to the general outline. But they would not have to bear the responsibility before their electors; they would not have to fight
it out; they would not have to take unpopular decisions. Governor Horowitz said he was ready to pay a certain price to get the plan going. To get the shift of real resources, which could not be accomplished by frontal attack, he was trying an outflanking manoeuvre. The frontal attack was hopeless. Prejudices were too strong. We lived in a democracy and wanted to live in a democracy, but account must be taken of all of the shortcomings and lack of thinking. The economy was extremely intricate and complicated and much less understandable to the plain man in the street and to his representative than it was fifty or a hundred years ago. Governments were much more enlightened, but they were composed of professionals. Some stratagem, some way of treating very complicated matters, must be found for people who did not have the insight into the intricate working of the complicated machinery. Some way must be found to get round this difficulty, so that the very urgent problem, on which the fate of the world depended, could be solved. Ways had been found before to present various programs, such as the New Deal. It was necessary to take account of the fact that the economic thought of legislative bodies lagged behind the realities of the situation. They had to be offered the easier way. He believed that governments were much more ready to meet the problem than parliaments. Assistance programs in the United States would be much larger if the executive branch were completely free to make allocations. The proposals of the Administration were always larger than the amounts actually appropriated. The problem was very intricate. His present audience understood it because it was accustomed to dealing with the problem; the broad mass of people did not.

57. Governor Horowitz commented that if the Bank had to raise $800 million annually by allocations from governments, it would find that a very difficult task. This was so even though the balance of payments consequences of allocations and borrowings would be exactly the same. Yet legislatures did not oppose Bank borrowing. But if $800 million a year had to be obtained by going hat in hand from government to government, and legislative ratification was necessary, he was ready to wager that the Bank would not succeed.

58. Governor Horowitz agreed with the point which had been made that there was no necessary coincidence between a surplus in the balance of payments and the liquidity of the capital market. The method of floating issues in various amounts in various countries would have to be very flexible. It was premature, however, to consider what particular criteria should be applicable. Certainly the balance of payments problem would be a relevant factor in the distribution of the burden among the various countries.

59. It was not proposed to borrow unlimited amounts. He had suggested an initial period of five years, with $600 million to be raised each year. He did not think that $600 million, against the total of $35 billion issues floated and with rising GNP and so on, could upset the market. The amount
was just not large enough. The interest equalization feature was one limitation, the guarantee was another, so it was clear that amounts raised must remain within very modest limits.

60. The U.K.-Swedish proposal was not inconsistent with his plan, Governor Horowitz said. His dealt with the raising of money, and the other with the utilization of money. Thus the proposals were not only not contradictory, they were complementary. Money could be raised with his plan and spent under the other.

61. Governor Horowitz said he did not claim perfection for his plan. What he did claim for it was initiative, initiative to find a new point of departure. He was encouraged by the fact that not only in economic science; but in physics and other fields, complicated and tremendous tasks were being taken on with tremendous success. Somehow, financial allocations had bogged down and lagged behind the tempo, the rhythm, and the vision of the century.

62. Mr. Woods said that Governor Horowitz's comments and responses to the observations of the Directors had been extremely interesting and, for himself, most helpful. He believed that Governor Horowitz could feel sure that there was an understanding in the Board of what Governor Horowitz was driving at. The discussion had been interesting, worthwhile and thought-provoking. Governor Horowitz replied that he had greatly enjoyed and profoundly appreciated the opportunity to appear.

DSD(SB)
July 19, 1965
May 7, 1965

Dear Governor Horowitz:

Thank you for your letter of April 30.

I note that you plan to participate in the negotiations on the Industrial Development Bank loan even if that should require you to postpone your coming to Washington beyond the end of May. There will be no difficulty in arranging for you to address the Executive Directors while you are here, and we shall plan to do that. When the timing of the loan negotiations is settled, we shall suggest a date for your presentation.

With kind regards,

Sincerely yours,

(Signed) George D. Woods

George D. Woods

Governor David Horowitz
Bank of Israel
Jerusalem, Israel

cc: Mr. Mendels with copy of incoming letter
Cleared in substance and cc: Messrs Cope/Jeffries
cc: Mr. Demuth

May 6, 1965
Dear President Woods,

Thank you for your letter of April 14 and for your kind invitation to address the Executive Directors of the Bank on my proposal.

I understand that the negotiations in connection with the loan to the Industrial Development Bank may take place at the end of May or sometime in June. It would be convenient if my meeting with the Executive Directors could be arranged at the same time, when I shall be coming anyhow to Washington on behalf of my Government and the Bank of Israel, even if this should be later than May.

As in previous loans, the signing of the Loan Agreement will be done by our Ambassador in Washington, and this will not necessitate my presence in Washington while I would like to participate in the negotiations preceding the loan agreement relating to the terms and duration of the loan.

I think this date would meet all the requirements, as it would also be after Mr. Demuth's return to Washington. I shall, of course, be honoured and pleased to address the Board or the Executive Directors on this occasion.

With kindest regards,

Yours sincerely,

D. Horowitz

Original in Israel-Deb. Bank project.

D. Horowitz, Gov. David

Date: May 7, 1965
April 14, 1965

Governor David Horowitz
Bank of Israel
Jerusalem, Israel

Dear Governor Horowitz:

Dr. Lieftinck has conveyed to me your wish, now that the Bank staff report on "The Horowitz Proposal" has been sent to the United Nations, to accept the invitation which I extended to you last year to address the Executive Directors of the Bank on the subject of the proposal, and your hope that the presentation might take place before the end of May. I understand from Dr. Lieftinck that you would be pleased if your presence in Washington should happen to coincide with the signing of the proposed loan to the Industrial Development Bank of Israel.

I shall be glad to make arrangements for your appearance before the Executive Directors. There should be no difficulty in complying with your request that this be done before the end of May. However, in view of Mr. Demuth's role in the preparation of the Bank staff report, I would like your presentation to be made when he is here. He is now in Turkey as chief of a Bank mission and will not be returning to the Bank until May 12. I therefore suggest that, if it suits your convenience, you might address the Board sometime during the following two weeks, between May 17 and May 26. The precise date can be set after you let me know whether this would fit in with your plans. Mr. Demuth has been informed that you would like to meet with the Executive Directors and, should you wish to consult with him on timing, he can be reached in Ankara at the Hotel Balin.

As you may know, progress at this end on the proposed development bank loan is awaiting the provision of further information from the development bank, chiefly in regard to the bank's financial plans. If the information, which was requested some time ago, is received within the next few days, it would not be unrealistic to envisage that loan negotiations might be completed in time to permit presentation of the loan to the Board and a loan signing in the latter part of May. But unless the data requested are submitted very soon, so that negotiations may be begun early in May, it is unlikely that the loan could be signed during that month. Dr. Lieftinck has impressed upon us that you would not wish your appearance before the Executive Directors to be delayed beyond May merely to enable you to be in
Governor David Horowitz

April 14, 1965

Washington for the final stages of the development bank loan. We shall keep in mind your interest in being here for the signing and if it is at all possible to arrange this we shall be pleased to do so.

With kind regards,

Sincerely yours,

(Signed) George D. Woods

George D. Woods

SBoskey/jk

Cleared with and cc: Mr. Jeffries

cc: Messrs. Scott
Fontein
Demuth
DATE OF WIRE: APRIL 1, 1965     1135 AM

LOG NO.: ITT 10

TO: INTRAFRAD

FROM: CARACAS

TEXT:

ROGAMOLES ENVIARNS STAFF STUDY ON THE HOROWITZ PROPOSAL ATENTAMENTE

CARLOS RAFAEL SILVA GERENTE
BANCO CENTRAL DE VENEZUELA

ROUTING

ACTION COPY: MR. WEINER
INFORMATION COPY: MR. ALTER
DECODED BY: NA
Dr. Luis Machado

Mervyn L. Weiner (through Mr. Chaufournier)

Venezuela: Incoming Cable attached

We have just received the attached cable request from the Central Bank of Venezuela for a copy of the Bank's Staff Study on the Horowitz Proposal.

I think it would be appropriate, and presume you would wish, that this request be replied to by you and the document sent to the Central Bank through your office. We shall accordingly not do anything further ourselves about this inquiry unless you so request.
March 22, 1965

Confidential

Dear Geoffrey,

Enclosed please find copies of two reports of mine.

1. One is on the DAC meeting concerning the Horowitz Report. We heard some quite interesting declarations, by representatives of several major countries, on the replenishment of IDA resources.

2. The second one is on a very important item on the Agenda of the meeting in New York, to start on April 5, of the UNCTAD Trade and Development Board (TDB): the terms of reference of the Committee on Invisibles and Financing of UNCTAD.

The text of the Resolution that created the Committee is very vague. In a broad interpretation the text might give sweeping powers to the Committee enabling it to give instructions to international institutions, influence their policy-making process, etc.

The discussion of the item will, therefore, be of great interest to us. I was invited to attend, on a personal and very confidential basis, a caucus of the DAC nations. The subject of discussion included two draft proposals (enclosed) by the U.K. and U.S. The caucus did not take any decision and will discuss both texts at another meeting, to be held in New York before the opening of TDB.

It was nice to have seen you in Paris.

With best regards.

Sincerely yours,

Arthur Karasz

Enclosures

Mr. Geoffrey M. Wilson
Vice President, International Bank for Reconstruction and Development
Washington, D.C. 20433
Item 7C of the Provisional Agenda of the Trade and Development Board (TDB) First Session is Terms of Reference of the Committee on Invisibles and Financing related to Trade.

1. The Committee was created on June 15, 1964, the last day of UNCTAD. The text of the Resolution is not clear; with broad interpretation it could give sweeping powers to the Committee: it might have the right to summon international institutions, ask for reports from us, influence our policy, and so on.

   Membership, programme, terms of reference of the Committee will be decided at the forthcoming meeting of TDB (New York, April 5).

2. The Western Group of nations is rather nervous about the Committee and considers item 7C of the provisional agenda as the most important subject the meeting will have to discuss.

   Confidential instructions were sent to all member countries on the attitude the Executive Committee of OECD would like them to take in this matter. As I reported in previous papers on this subject, the main ideas of the instructions are negative, as follows:

   a) The Committee should not have operational activities.

   b) Duplication and overlapping with international institutions, particularly IBRD and IMF, should be avoided.

   c) The Committee should not have the right to examine development plans (UNCTAD A.IV.2).

   d) The Committee should not deal with the following:

       International monetary issues (A.IV.19)
       Review of external debt (A.IV.5).

   e) The Committee should not have powers impairing the autonomy of other institutions (like IBRD).

3. On March 19 I was invited to an internal and confidential meeting of DAC nations (Belgium, France, Germany, Italy, Japan, Netherlands, U.K. and U.S.).

   The Subject was the discussion of a draft proposal to be submitted to TDB on the terms of reference of the Committee.
The following two texts were discussed:

**U.K. Proposal**

"The Committee shall keep under review trends and measures and make recommendations to the Board in the fields of financing for the expansion of international trade and improving the invisible trade of developing countries.

"The Committee shall, in accordance with the unanimous wish expressed by the First United Nations Conference on Trade and Development, take fully into account the desirability of avoiding activities which duplicate or overlap with those of other organs and institutions within the United Nations family and other relevant inter-governmental institutions."

**U.S. Proposal**

"The Committee on Invisibles and Financing Related to Trade shall consider studies and proposals regarding financing for an expansion of international trade, and formulate recommendations thereon to the Trade and Development Board. The Committee shall especially consider studies and proposals concerning the volume and terms of financing for the exports of the developing countries and for their import of essential goods and services. The Committee shall consider the role of invisibles in the balance of payments of developing countries with a view to improving their balance on invisible trade. At the request of the Trade and Development Board, the Committee may consider any other subject in the area of invisibles and financing related to developing countries' trade problems, as they affect their economic development, that is assigned to the Conference and the Board in GA Res. 1995 (XIX) establishing the UNCTAD machinery. In carrying out its functions, the Committee shall take into account the work of the competent organs of the United Nations, the specialized agencies, and other international organizations, and take care to avoid duplication and overlapping of their activities."

The meeting was unable to agree on a definitive formula. Discussions will continue in the caucus of DAC nations in New York.

4. We know that rival proposals are in preparation at caucuses of the "77" (particularly the new ECLA caucus of Lima). Therefore, the negotiations of the terms of reference will be a rather delicate affair.

I was requested to underline the extremely confidential nature of the subject.

cc: Mr. Wilson
    Mr. Miller
    Mr. Gordon
On March 19 the DAC Working Party on UNCTAD Issues discussed the Bank's Horowitz Report. The Working Party is chaired by Mr. Elson, Germany, and has been enlarged for this occasion to include representatives of all OECD countries.

1. At the request of the chairman, I made a summary of the contents of the Report. As was to be foreseen, some of the delegates were influenced by press articles, like the one published in the Economist ("Cold douche for Horowitz", February 27); there were some rumors that IBRD has "killed the Horowitz Proposal".

In my answer I explained the technical background of the paper and that ended the discussion in this group.

However, this is probably not the end of the story; later at UNCTAD meetings this same subject will probably be brought up in a much stronger form by representatives of Part II countries.

2. The OECD governments do not yet have definitive conclusions on the Horowitz Proposal as such. (This first tentative conclusion is negative, mainly for the reasons discussed in the IBRD study.)

What was remarkable in the meeting was the positive attitude toward a new replenishment of IDA resources showed by several representatives of DAC countries.

a. The German delegate (Koinzer) declared, for instance, that his government would be ready to participate in another round of IDA replenishment. One detail to be clarified is whether such replenishment will be done - as in the past - with direct, budgetary contributions or with one of the alternate methods described in the Bank's Horowitz study.

b. The United States delegate (Zagorin) went into great details to express his government's satisfaction with the Bank study. The U.S. government is ready to give all its attention on how to contribute more to IDA. The Bank's study is most useful, not only because it explores all the technicalities of the proposal but also elucidates the interrelationship between the Horowitz proposal and the need for future contributions to IDA. In short, by studying the Horowitz proposal, it opened the door toward new discussions on IDA replenishment.

That is why the alternate methods discussed in the Bank's paper (increased contribution to IDA, system of multilateral guarantees, etc.) are of such interest; the United States government will continue studying them and similar proposals.
c. The Netherlands (Liefrinck) agrees to discuss one or other form of further contributions to IDA, with the only condition that the ratio of contributions from individual governments be put on a more equitable basis.

d. The United Kingdom (Errock) agrees with the Netherlands opinion.

3. The Working Party decided the following: The findings of IBRD on the Horowitz Scheme are still under consideration by the governments, therefore the Western Group of nations will try to avoid any detailed discussion of the IBRD Horowitz Study at the forthcoming meeting of the Trade and Development Board.

A broader aspect of the problem is how to enable international organizations to lend on IDA-type conditions. This matter will continue to be kept under discussion.

cc: Mr. Woods
    Mr. Wilson
    Mr. Friedman
    Mr. Miller
    Mr. Gordon
**ROUTING SLIP**

**OFFICE OF THE PRESIDENT**

<table>
<thead>
<tr>
<th>Name</th>
<th>Room No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mr. Bemuth</td>
<td></td>
</tr>
<tr>
<td>Mr. Boardman</td>
<td></td>
</tr>
<tr>
<td>Mr. Cooper</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Action</th>
<th>Note and File</th>
</tr>
</thead>
<tbody>
<tr>
<td>Approval</td>
<td>Note and Return</td>
</tr>
<tr>
<td>Comment</td>
<td>Prepare Reply</td>
</tr>
<tr>
<td>Full Report</td>
<td>Previous Papers</td>
</tr>
<tr>
<td>Information</td>
<td>Recommendation</td>
</tr>
<tr>
<td>Initial</td>
<td>Signature</td>
</tr>
</tbody>
</table>

**Remarks**

Fr [Signature]
Dear Mr. Woods,

Last Friday a DAC Group, enlarged to include all member countries of OECD, discussed our Horowitz Report. I explained our position according to your instructions and there was slight resistance only.

I enclose a copy of my report. It deals more with IDA replenishment than with Horowitz. As you will see from it, representatives of several major industrialized countries had quite encouraging observations to make on the subject of IDA.

I would like to thank you for the opportunity you gave me in Paris to report on DAC and UNCTAD matters.

Incidentally - to end with a personal note - I have just received news from my son, now at the University of Chicago, that he has been awarded a quite good Ford Foundation fellowship to do graduate research on ... Trade and Development.

With kind regards.

Sincerely yours,

Arthur Karasz

Enclosure

Mr. George D. Woods
President of the International Bank for Reconstruction and Development
Washington, D.C. 20433
On March 19 the DAC Working Party on UNCTAD Issues discussed the Bank's Horowitz Report. The Working Party is chaired by Mr. Elson, Germany, and has been enlarged for this occasion to include representatives of all OECD countries.

1. At the request of the chairman, I made a summary of the contents of the Report. As was to be foreseen, some of the delegates were influenced by press articles, like the one published in the Economist ("Cold douche for Horowitz", February 27); there were some rumors that IBRD has "killed the Horowitz Proposal".

   In my answer I explained the technical background of the paper, and that ended the discussion in this group.

   However, this is probably not the end of the story; later at UNCTAD meetings this same subject will probably be brought up in a much stronger form by representatives of Part II countries.

2. The OECD governments do not yet have definitive conclusions on the Horowitz Proposal as such. (Their first tentative conclusion is negative, mainly for the reasons discussed in the IBRD study.)

   What was remarkable in the meeting was the positive attitude toward a new replenishment of IDA resources showed by several representatives of DAC countries.

   a. The German delegate (Kleinzer) declared, for instance, that his government would be ready to participate in another round of IDA replenishment. One detail to be clarified is whether such replenishment will be done - as in the past - with direct, budgetary contributions or with one of the alternate methods described in the Bank's Horowitz study.

   b. The United States delegate (Zagorin) went into great details to express his government's satisfaction with the Bank study. The U.S. government is ready to give all its attention on how to contribute more to IDA. The Bank's study is most useful, not only because it explores all the technicalities of the proposal but also elucidates the interrelationship between the Horowitz proposal and the need for future contributions to IDA. In short, by studying the Horowitz proposal, it opened the door toward new discussions on IDA replenishment.

   That is why the alternate methods discussed in the Bank's paper (increased contribution to IDA, system of multilateral guarantees, etc.) are of such interest; the United States government will continue studying them and similar proposals.
c. The Netherlands (Liefrinck) agrees to discuss one or other form of further contributions to IDA, with the only condition that the ratio of contributions from individual governments be put on a more equitable basis.

d. The United Kingdom (Errock) agrees with the Netherlands opinion.

3. The Working Party decided the following: The findings of IBRD on the Horowitz Scheme are still under consideration by the governments, therefore the Western Group of nations will try to avoid any detailed discussion of the IBRD Horowitz Study at the forthcoming meeting of the Trade and Development Board.

A broader aspect of the problem is how to enable international organizations to lend on IDA-type conditions. This matter will continue to be kept under discussion.

cc: Mr. Woods
    Mr. Wilson
    Mr. Friedman
    Mr. Miller
    Mr. Gordon
Dear Mr. Friedman,

With your letter of February 15 you were so kind as to forward me a copy of the World Bank staff report on the proposal of Governor Horowitz, as it has been transmitted to the Secretary General of the United Nations. I am very pleased to have this interesting report, for which I am much obliged.

Yours sincerely,

[Signature]
Mr. Irving S. Friedman  
Economic Adviser to the President  
International Bank for Reconstruction and Development  
1818 H Street, N.W.  
Washington, D.C. 20433

Dear Mr. Friedman,

On return to the office from holidays I find the Staff Report on the Horowitz Proposal, for the sending of which I thank you. I gladly assure you that in due course I shall give it my full attention.

Yours sincerely,

(Dr. M.W. Holtrop)
Amsterdam, February 26, 1965.
Vijzelstraat 32.

Mr. I.S. FRIEDMAN,
The Economic Adviser to the President
International Bank for Reconstruction and
Development
1818 H Street, N.W.,
WASHINGTON, D.C. 20433.
U.S.A.

Dear Mr. Friedman,

Many thanks for your kind letter of the 15th instant as well as for the copy of your Bank's Staff Report on the Horowitz proposal which you had the thoughtfulness to send me.

With much interest I have read this study, which I am really glad to have at my disposal for later reference.

Please be assured of my Bank's complete willingness to be of service to you at any time.

With kindest personal regards,

Sincerely yours,

[Signature]
Mr. H. A. Fullerton
The Economic Adviser to the President
International Bank for Reconstruction and
Development
1515 H Street, N.W.
Washington D.C. 20433
U.S.A.

Dear Mr. Frazier:

Many thanks for your kind letter of the 15th instant. We feel sure that the copy of your Bank's Staff Report on the International Bank's Program, which you have forwarded to me, will be of interest. I have read this report with great care.

Please be assured of my Bank's complete willingness to be of service to you at any time.

With kind regards,

Sincerely yours,

[Signature]
Cher John,

Je reçois à l'instant le communiqué de presse de la BIRD daté du 15 Février 1965, concernant l'étude sur la proposition de Monsieur Horowitz.

Je n'ai malheureusement aucune documentation à ce sujet ; aussi, je vous serais très reconnaissant s'il était possible de m'envoyer le texte de cette proposition et quelques résultats relatifs à l'étude qui en a été faite par la Banque mondiale.

Avec mes vifs remerciements anticipés, je vous prie de recevoir, cher John, l'assurance de mes sentiments les meilleurs.

Georges A. Manouso
Représentant Résident du BAT
Directeur des Programmes SF

Mr. J.H. Williams
Assistant Director
Africa Department BIRD
1818 H Street N.W.
Washington D.C.
Par valise

Cher John,

Je reçois à l'instant le communiqué de presse de la BIRD daté du 15 Février 1965, concernant l'étude sur la proposition de Monsieur Horowitz.

Je n'ai malheureusement aucune documentation à ce sujet ; aussi, je vous serais très reconnaissant s'il était possible de m'envoyer le texte de cette proposition et quelques résultats relatifs à l'étude qui en a été faite par la Banque mondiale.

Avec mes vifs remerciements anticipés, je vous prie de recevoir, cher John, l'assurance de mes sentiments les meilleurs.

Georges A. Manoussou
Représentant Résident du BAT
Directeur des Programmes SF

Mr. J.H. Williams
Assistant Director
Africa Department BIRD
1818 H Street N.W.
Washington D.C.
Dear Mr. Taub:

In response to your letter dated February 5 to Mr. M.M. Mendels, Secretary of the International Bank for Reconstruction and Development, this will confirm that we are forwarding 50 copies of "The Horowitz Proposal". As requested, 10 copies of the report are being sent by air mail and the remaining 40 copies by surface mail. There is no charge for this service.

Sincerely yours,

(Mrs.) Doris R. Eliason
Office of Information

Mr. Y.J. Taub
Secretary General
Bank of Israel
Jerusalem
ISRAEL

ps
February 22, 1965

Mr. Irving S. Friedman  
Economic Adviser to the President,  
International Bank for  
Reconstruction and Development  
1818 H Street, N.W.  
Washington, D.C. 20433

Dear Mr. Friedman,

I just received your report on the Horowitz proposal, for which I thank you very much. I look forward with the greatest interest to reading it, and I shall, of course, make it available to my associates in the Bundesbank.

Sincerely,

[Signature]
Mr. Irving S. Friedman,  
The Economic Adviser to the President,  
International Bank for Reconstruction and Development,  
1818 H Street, N.W.,  
Washington, D.C. 20433

Dear Mr. Friedman:

Very many thanks for your letter of February 15th and your thoughtfulness in sending me the staff report on the Horowitz proposal. Incidentally, I shall be in Washington on March 8th and 9th and hope to see you on that occasion.

Yours sincerely,

[Signature]
Mr. Richard H. Demuth, Director
Development Services Department
International Bank for Reconstruction
and Development
1818 H Street, N. W.
Washington, D. C. 20433

Dear Dick:

Thank you for your letter of February 12th with the copies of the Bank staff report on the Horowitz proposal which Mr. Woods has just transmitted to the Secretary-General of the United Nations. We are happy to have these and I have given copies to Mr. Pattberg and Mr. Townsend.

We were pleased to have had an opportunity to work with you on this matter.

All the best to you.

Sincerely yours,

A. N. Overby
### FORM No. 89

**INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT**

**INTERNATIONAL DEVELOPMENT ASSOCIATION**

**INTERNATIONAL FINANCE CORPORATION**

---

**ROUTING SLIP**

**Date**

Feb. 24, 1965

---

**OFFICE OF THE PRESIDENT**

<table>
<thead>
<tr>
<th>Name</th>
<th>Room No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Mr. Woods</td>
<td></td>
</tr>
<tr>
<td>2. Mr. Denuth</td>
<td></td>
</tr>
</tbody>
</table>

---

<table>
<thead>
<tr>
<th>Action</th>
<th>Note and File</th>
</tr>
</thead>
<tbody>
<tr>
<td>Approval</td>
<td>Note and Return</td>
</tr>
<tr>
<td>Comment</td>
<td>Prepare Reply</td>
</tr>
<tr>
<td>Full Report</td>
<td>Previous Papers</td>
</tr>
<tr>
<td>Information</td>
<td>Recommendation</td>
</tr>
<tr>
<td>Initial</td>
<td>Signature</td>
</tr>
</tbody>
</table>

---

**Remarks**

To see.

---

G. C. Wishart
Mr. George D. Woods, President
International Bank for Reconstruction
and Development
Washington, D.C. 20433
U. S. A.

Dear President Woods,

Many thanks for the text of the Bank Staff Report which you were so kind to send me, together with your letter of February 12.

I am most grateful to you for your kind remark as to the value of the proposal for the international community. I hope it will contribute in a modest way to our common objective of accelerating economic growth in developing nations.

Sincerely yours,

D. Horowitz
Please bring this to the notice of all concerned.

G. D. Woods
19 February 1965

Dear Mr. Woods,

I acknowledge receipt of your kind letter of 12 February with which you sent me a copy of a study undertaken by the International Bank for Reconstruction and Development at the request of the United Nations Conference on Trade and Development, of a "Development Financing Plan" which was submitted to the Conference by the Chairman of the delegation of Israel. I should like to take this opportunity to express our appreciation for the Bank's co-operation in preparing this report which I look forward to reading at the earliest opportunity.

I have also noted that this study has been prepared by the Bank staff and does not purport to represent the views of the Executive Directors of the Bank or of the governments which appointed or elected them.

Yours sincerely,

[Signature]

U Thant

Mr. George D. Woods, President
International Bank for Reconstruction and Development
Washington D.C. 20433
RECEIVED
GENERAL FILES
COMMUNICATIONS

1965 FEB 25 AM 8:40

[Handwritten text]

[Handwritten signature]
Mr. Irving S. FRIEDMAN  
The Economic Adviser to the President  
INTERNATIONAL BANK FOR RECONSTRUCTION  
AND DEVELOPMENT  
INTERNATIONAL DEVELOPMENT ASSOCIATION  
1818 H Street, N.W.  
WASHINGTON, D.C. 20433  
USA

Dear Mr. Friedman:

Many thanks for your kind letter of February 15 and your thoughtfulness to send me the Staff Report THE HOROWITZ PROPOSAL. I shall study it with great interest.

It was a pleasure for my colleagues and me to be of assistance in the matter.

With kind regards,

Sincerely yours,
February 18, 1968

FRANKFURT (MAIN)

21 FEBRUARY 1968

DEUTSCHE BANK AG

M. Irving S. FRIEDMAN
The Economic Adviser to the President
INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION
1818 H Street, N.W.
WASHINGTON, D.C. 20433
USA

Dear Mr. Friedman:

Thank you for your kind letter of February 18 and your thoughtfulness in sending me the staff report THE NORMITS PROPOSAL. I shall study it with great interest.

It was a pleasure for my colleagues and me to be of assistance.

Sincerely yours.
By Air Mail

18 February 1965.

Dear Mr. Friedman,

Thank you for your letter of the 15th February. I am grateful to you for sending me a copy of the staff report on the Horowitz proposals. I shall read this with great interest.

I am glad that you feel that we were able to be of some help to you.

Yours sincerely,

[Signature]

Mr. Irving S. Friedman,
International Bank for Reconstruction and Development,
1818, H Street, N.W.,
WASHINGTON, D.C. 20433,
U.S.A.
INCOMING WIRE

DATE OF WIRE: FEBRUARY 18, 1965
LOG NO.: TELEX
TO: INTRAFRAD
FROM: PARIS

TEXT:

97 FOR CAVANAUGH
DEUTSCHE BANK ANXIOUS OBTAIN
2 COPIES OUR STUDY HOROWITZ
PLAN COULD YOU BRING THEM.
THANKS KIND REGARDS

LESSEPS

ACTION COPY: MR. CAVANAUGH
INFORMATION COPY:
DECODED BY:

FCA
DATE OF WIRE: FEBRUARY 17, 1965
LOG NO.: TELEX
TO: INTRAFARAD
FROM: PARIS

TEXT:

96 FOR DEMUTH
HOROWITZ BESTSELLER PLEASE HAVE 35
MORE COPIES AIRMAILED THANKS

KARASZ

FCA
**Routing Slip**

**Date:** Feb. 18, 1965

**Office of the President**

<table>
<thead>
<tr>
<th>Name</th>
<th>Room No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mr. Demuth</td>
<td></td>
</tr>
<tr>
<td>(Initial)</td>
<td>Signature</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Action</th>
<th>Note and File</th>
</tr>
</thead>
<tbody>
<tr>
<td>Approval</td>
<td>Note and Return</td>
</tr>
<tr>
<td>Comment</td>
<td>Prepare Reply</td>
</tr>
<tr>
<td>Full Report</td>
<td>Previous Papers</td>
</tr>
<tr>
<td>Information</td>
<td>Recommendation</td>
</tr>
<tr>
<td>Initial</td>
<td>Signature</td>
</tr>
</tbody>
</table>

**Remarks:** For information.

G. D. Woods
Dear George,

Thank you very much for the copy of the report prepared by the Bank staff on Governor Horowitz's "Development Financing Plan", which I will read with great interest.

I very much appreciate your congratulations upon my formal appointment as Secretary-General of UNCTAD. I, too, look forward to our close association, and your assurance of the Bank's continued cooperation will always find a warm echo on our part.

Sincerely yours,

Raúl Prebisch

Mr. George D. Woods
President
International Bank for
Reconstruction and Development
Washington, D.C. 20433
February 15, 1965

Mr. J. Q. Hollow  
Chief Cashier  
Bank of England  
London E.C.2, England

Dear Mr. Boskey,

In the months which have passed since you so kindly talked with me and my colleagues, Mrs. Boskey and Mr. de Lesseps, about the prospects for borrowing in your country's markets under the terms of the proposal submitted to the United Nations Conference on Trade and Development by Governor Horowitz, the Bank staff report on the proposal has been completed. Mr. Woods has just transmitted it to the Secretary General of the United Nations. I thought perhaps you might be interested in seeing the report, and I therefore enclose a copy.

May I take this occasion to thank you again for your help and courtesy and for the time and thought you and your associates devoted to our inquiry.

Sincerely yours,

Irving S. Friedman  
The Economic Adviser to the President

Enc.

863  
SJBoskey:tf
IDENTICAL LETTER SENT TO:

Mr. W. W. Morton
U.K. Treasury
Great George Street
London S.W.1, England

Mr. Andrew Carnwath
Barings Bros. & Co., Ltd.
3 Bishopsgate
London E.C.2, England

Mr. G. Gluck, General Manager
Dresdner Bank, A.G.
Gallusanlage 7
Frankfurt, Germany

Dr. Paul Krebs, Director
Deutsche Bank, A.G.
Junghofstrasse 5-11
Frankfurt, Germany

Mr. M. Pierre-Brossolette
Deputy Director of External Finance
Ministry of Finance
Paris, France

Mr. E. Lindegger, Manager
Credit Suisse
Paradeplatz 8
Zurich, Switzerland

Mr. D. C. Renooij, General Manager
Algemene Bank Nederlands, N.V.
Vijzelstr It 32
Amsterdam - C, The Netherlands

Dr. L. Lammers, Deputy General Manager
Amsterdamsche Bank, N.V.
Amsterdam
Herengracht 595

Mr. M. W. Holtrop, President
Nederlandsche Bank, N.V.
Amsterdam - C
Oude Turfmarkt 127-129

Mr. Maurice Schlogel, Deputy General Manager
Credit Lyonnais
19 Boulevard des Italiens
Paris, France
February 15, 1965

Mr. John Portsmore
Bank of England
London, E.C.2, England

Dear Jack,

In the months which have passed since you so kindly talked with me and my colleagues, Mrs. Boskey and Mr. de Lesseps, about the prospects for borrowing in your country's markets under the terms of the proposal submitted to the United Nations Conference on Trade and Development by Governor Horowitz, the Bank staff report on the proposal has been completed. Mr. Woods has just transmitted it to the Secretary General of the United Nations. I thought perhaps you might be interested in seeing the report, and I therefore enclose a copy.

May I take this occasion to thank you again for your help and courtesy and for the time and thought you devoted to our inquiry.

Sincerely yours,

Irving S. Friedman
The Economic Adviser to the President
IDENTICAL LETTER SENT TO:

Mr. O. Emminger, Director
Bundesbank
Bonn, Germany

Viscount Harcourt
Morgan Grenfell
23 Gt. Winchester St.
London E.C.2, England

Mr. Bernard de Margerie, Manager
Banque de Paris et des Pays Bas
3, Rue d'Antin
Paris, France

Mr. J. Meary, Manager
Societe General
29 Boulevard Haussmann
Paris, France
February 15, 1965

Subject: Staff Study on the Horowitz Proposal

The President of the World Bank, Mr. George D. Woods, has transmitted to the Secretary General of the United Nations a staff study on the proposal presented by the Governor of the Bank of Israel, Mr. David Horowitz, to the United Nations Conference on Trade and Development (UNCTAD) last summer in Geneva.

UNCTAD requested the Bank to study the Horowitz proposal, the aim of which is to achieve a substantial increase in the flow of capital on "soft" terms to the developing countries. Funds would be raised in private capital markets for administration by the International Development Association, an affiliate of the World Bank.

The World Bank staff has analyzed and commented on the technical and institutional issues raised by the proposal. To assist governments in evaluating the proposal's feasibility and desirability, the staff has also identified a number of policy questions. The report itself takes no position on the merits of the proposal.

The World Bank staff is engaged on several other special studies requested by the UNCTAD Conference; these deal with the foreign debt burden of developing countries, the use and terms of suppliers' credits, the influence of export earnings fluctuations on orderly economic development and multilateral investment insurance.
WOULD BE GRATEFUL IF 10 COPIES OF STAFF REPORT ON HOROWITZ PROPOSAL COULD BE AIRMAILED TO US. SHALL REIMBURSE EXPENSES THANKS,

TAUB ISRABANK

FCA
February 12, 1965

Mr. Andrew Overby, Vice Chairman
The First Boston Corporation
20 Exchange Place
New York, New York 10005

Dear Andy:

We have finally completed and have had printed the Bank staff report on the Horowitz proposal and Mr. Woods has just transmitted it to the Secretary-General of the United Nations. I enclose three copies (since you may wish to give copies to Messrs. Pattberg & Townsend), and I want to thank you again for the time and effort you spent in helping us in our analysis of the borrowing prospects under the proposal.

With kind regards,

Sincerely yours,

Richard H. Demuth
Director
Development Services Department

Encl. (3)
February 12, 1965

Mr. Dudley Schoales
Morgan Stanley & Co.
2 Wall Street
New York, New York 10005

Dear Dudley:

We have finally completed and have had printed the Bank staff report on the Horowitz proposal and Mr. Woods has just transmitted it to the Secretary-General of the United Nations. I enclose three copies for you and your associates, and I want to thank you again for the time and effort you spent in helping us in our analysis of the borrowing prospects under the proposal.

With kind regards,

Sincerely yours,

Richard H. Demuth
Director
Development Services Department

Encls. (3)
February 12, 1965

Governor David Horowitz
Bank of Israel
Jerusalem, Israel

Dear Governor Horowitz:

I take pleasure in sending you with this letter the final text of the Bank staff report prepared in response to the request of the United Nations Conference on Trade and Development that the Bank study and report to the United Nations on the proposal you submitted to the Conference. I have today transmitted the report to U Thant. As I said in my letter to him, you deserve the thanks of the international community for focussing attention, through your proposal, upon the urgent problem of how best to achieve a substantial increase in the resources of the International Development Association.

Cordially,

(Signed) George D. Woods

George D. Woods

Enc. (1)

84
Sboskey/jk
February 4, 1965
February 12, 1965

U Thant
The Secretary-General
United Nations,
New York, N.Y.

Dear U Thant:

The International Bank, as you know, was requested by the United Nations Conference on Trade and Development (UNCTAD) to study "The Development Financing Plan" submitted to the Conference by the head of Israel's delegation, the Governor of the Bank of Israel, Mr. D. Horowitz, and to submit a report on the plan to the United Nations. In response to that request I am pleased to send you with this letter a copy of a study entitled "The Horowitz Proposal". As the introduction states and as the Bank's representative at UNCTAD, in accepting the commission, made plain would be the case, this is a study prepared by the Bank staff; it does not purport to represent the views of the Executive Directors of the Bank, or of the governments which appointed or elected them, concerning the issues which it discusses.

As I had occasion to remark in my address to the Conference, a greatly increased proportion of development assistance must in future be made available on terms which impose a minimal debt service burden upon the recipient countries. The reasons for, and the magnitude of, the need for aid on soft terms are the subjects of other studies on which the Bank staff is now at work. Insofar as assistance on a multilateral basis is concerned, the principal and immediate problem is how best to achieve a substantial increase in the resources of the International Development Association. I am sure you will agree that Governor Horowitz deserves thanks for focussing attention on this problem by his provocative suggestion for one possible approach to its solution.

Sincerely yours,

(Signed) George D. Woods

George D. Woods
OUTGOING WIRE

TO: KARASZ
    INTBAFRAD
    PARIS

DATE: February 12, 1965

CLASS OF SERVICE: Telex

COUNTRY: FRANCE

TEXT:

CABLE No.: 101

COPIES HOROWITZ REPORT SENT AIR FRANCE FLIGHT 24 DUE SATURDAY
FEBRUARY TEN FIFTYFIVE AM PARIS AIR BILL NO 0570392639

LIND

NOT TO BE TRANSMITTED

MESSAGE AUTHORIZED BY:

NAME Lars J. Lind

DEPT. Office of Information

SIGNATURE (Signature of Individual Authorized to Approve)

CLEARANCES AND COPY DISTRIBUTION:

LJL:ap

ORIGINAL (File Copy)

(IMPORTANT: See Secretaries Guide for preparing form)

Checked for Dispatch:
DATE OF WIRE: FEBRUARY 5, 1965
LOG NO.: TELEX
TO: INTRA FRAD
FROM: PARIS

TEXT:

75 FOR DEMUTH

THANKS YOUR CABLE ON HOROWITZ. OECD DAC REQUEST
25 COPIES POSSIBLY FEBRUARY 15 REGARDS

KARASZ

FCA
Mr. M.M. Mendels,
Secretary,
International Bank for Reconstruction and Development,
Washington, D.C. 20433,
U. S. A.

Dear Mr. Mendels,

I cabled to you today as follows:

"WOULD BE GRATEFUL IF TEN COPIES OF STAFF REPORT ON HOROWITZ PROPOSAL COULD BE AIRMAILED TO US SHALL REIMBURSE EXPENSES THANKS"

I would greatly appreciate it if you could arrange for us to receive 50 copies of the Staff Report on "The Horowitz Proposal", 10 of which by airmail and the remaining 40 by surface mail.

We shall, of course, reimburse all expenses incurred in this connection.

Sincerely yours,

Y. J. Taub
Secretary General (Acting)
Dear Mr. Mendele,

I am writing to you today for the following:

I would be greatly interested in the current or status report on the
Horowitz proposal and would be interested if the report could be
forwarded as soon as possible.

I would greatly appreciate it if you could forward
for me to receive 50 copies of the draft report on the Horowitz
Proposal, if at all possible in the next 10 days.

We are of course interested in the experience.

In this connection,

Yours truly,

[Signature]

Director General

[Stamp: Secretariat General (official)]
75 FOR DEMUTH

THANKS YOUR CABLE ON HOROWITZ. OECD DAC REQUEST
25 COPIES POSSIBLY FEBRUARY 15 REGARDS

KARASZ
DATE OF WIRE: FEBRUARY 4, 1965
LOG NO.: TELEX
TO: INTRAFAQD
FROM: PARIS

TEXT:

73 FOR DEMUTH COPY FRIEDMAN
DAC ELSON GROUP MEETING FEBRUARY 16 WISHES
DISCUSS OUR HOROWITZ REPORT AND REQUESTS
SUFFICIENT NUMBER OF COPIES "SUFFICIENTLY
IN ADVANCE". WOULD IT BE POSSIBLE HAVE
SENT US ABOUT 15 COPIES FOR BEGINNING NEXT
WEEK? THANKS

KARASZ

FCA
OUTGOING WIRE

TO: KARASZ INTAFAFRAD

DATE: February 4, 1965

COUNTRY: PARIS

TEXT:
FINAL TEXT HOROWITZ REPORT WITH NUMEROUS BUT MINOR CHANGES FROM VERSION YOU
HAVE NOW AT PRINTER STOP WHEN RETURNED FROM PRINTER PROBABLY NOT BEFORE
FEBRUARY 12 WOODS WILL TRANSMIT TO UNITED NATIONS STOP CAN SEND YOU COPIES
THEN BUT UNLIKELY ARRIVE PARIS BEFORE FEBRUARY 15 REGARDS

DEMUTH

NOT TO BE TRANSMITTED

MESSAGE AUTHORIZED BY:

NAME Richard H. Demuth
DEPT. Development Services Department

SIGNATURE (SIGNATURE OF INDIVIDUAL AUTHORIZED TO APPROVE)
SBoskey/jk

CLEARANCES AND COPY DISTRIBUTION:

cc: Mr. Friedman

For Use by Archives Division

Original (File Copy)
(IMPORTANT: See guide for preparing form)
OUTGOING WIRE

DATE: February 7, 1975

TO: INTERTRADE

CLASS: OF

SERVICE: M/T

COUNTRY: PARIS

TEXT:

Final text monopoly report with numerous but minor changes from previous version. Have now at printer stop when returned from printer properly not received. Will forward to Woods until transmitted to United Nations stop. Can send you copies. Then will undoubtedly arrive Paris before February 15, perhaps?

Dimitri

NOT TO BE TRANSMITTED

AUTHORIZATION:

NAME

DEPT

Development Service Department

SIGNATURE:

I. M. Pleshanov

FOR USE BY ARCHIVES DIVISION

CONFIDENTIALITY OR INDIVIDUAL AUTHORIZED TO AMEND

FOREIGN (not copy)

IMPORTANT: See guide for blanking form.)
Statement on Horowitz Proposal Report

As you know I did not use the attached statement at the Board Meeting today. You might note the fact that I spelled out the last sentence somewhat and I suggest that you do so again when Mr. Woods delivers this statement.

Attach.
As you will remember, we asked the Executive Directors to give us any comments they might have on the Horowitz report by the end of Friday, January 22. We heard from Donner, Rajan, Gutierrez Cano and Garba. Gutierrez Cano and Garba suggested no changes, Rajan's proposals were minor and we took account of the principal one, and Donner is satisfied with the disposition made of his. Hirschtritt told me last week that the U.S. had some comments but couldn't give them to us by Friday. He is coming in with them tomorrow (Thursday) afternoon just after lunch, presumably with specific language changes to propose. Since I don't know exactly what he has in mind, and won't know until literally the time of the Board meeting whether we can reach agreement or will still be discussing his proposals, it is difficult to suggest now what you might say to the Board. I will let you know just before the meeting begins whether we are still in consultation, in which event probably nothing should be said, or whether we have reached agreement. On the assumption that we find that we can readily accommodate Hirschtritt, you might wish to say something along the lines of the attached.

Attach.

SEB:tf
I might say a word about the status of the Bank staff report on the Horowitz proposal. We have now heard from those Executive Directors who wished to comment. There were very few who did and only a few minor changes in the text of the report had to be made in consequence of those comments. The report is now in the hands of the printer, and we expect to send it to the Secretary General of the United Nations in perhaps 10 days or so. Mr. Woods' letter of transmittal to U Thant will call attention to the statement in the report itself that it is a staff study.
**Routing Slip**

**Date:** Jan. 27, 1965

**Office of the President**

<table>
<thead>
<tr>
<th>Name</th>
<th>Room No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mr. Demuth</td>
<td>Mrs. Bosley</td>
</tr>
</tbody>
</table>

**Action** | **Note and File**
--- | ---
Approval | Note and Return
Comment | Prepare Reply
Full Report | Previous Papers
Information | Recommendation
Initial | Signature

**Remarks**

I don't suppose there is any further action required on this.

G. D. Woods
Mr. George D. Woods
President
International Bank for Reconstruction
and Development
Washington, D.C. 20433
U. S. A.

Dear President Woods,

Many thanks for your letter of January 8.

I am enclosing herewith a letter and two expert opinions sent to me by Mr. Walter Heller, when he was Chairman of the Council of Economic Advisers. Also enclosed is an excerpt from a speech by Mr. Philippe de Seynes, UN Under-Secretary for Economic and Social Affairs.

I thought these comments on my plan may be of some interest to you.

Sincerely yours,

D. Horowitz
September 3, 1964

Dear Mr. Horowitz:

I gave the material on the Israeli development financing plan to our staff economist who works in this area and I am enclosing her comments for your interest.

I greatly enjoyed our discussion in my office, and I look forward to seeing you again soon.

With warm regards,

(-)

Walter W. Heller

Mr. D. Horowitz
Head of the Israel Delegation
Governor, Bank of Israel
UN Conference on Trade and Development
Geneva, Switzerland

Enclosure
UNITED STATES GOVERNMENT
MEMORANDUM

To: Walter W. Heller
from: P. Thunberg

Subject: Comments on Israeli LDC Financing Plan

At UNCTAD the Israeli delegates proposed an expansion of the lending resources of IDA by sale of IDA securities on commercial terms. The difference between the cost of money to IDA and the price charged by IDA for the use of the funds (1%) by the LDC's on long term would be covered by an Interest Equalization Fund to be provided by the large aid donors. This plan would supplement the existing activities of the IBRD and IDA as well as the present volume of bilateral aid flowing between governments. Since the IDA bonds would be sold on private markets, the plan might to some degree supplant the volume of private investment flowing to the LDC's, but probably not significantly.

The plan is commendable. There is general agreement that, if the developing countries are to achieve the growth rates which both we and they consider desirable, a larger transfer of resources than that currently taking place is necessary. Because of the limitations that are typically attached to bilateral aid arrangements, it is especially desirable that multilaterally supported sources be expanded.

There are dangers, however, in a further multiplication of autonomous lending agents. The developing countries, impelled by internal pressures for rapid growth, have exhibited little self-discipline in managing their external financial affairs.
The rate at which they are currently adding to their external indebtedness is the cause of considerable concern. The IBRD estimates that the medium and long-term public and publicly-guaranteed external debt of these countries increased at an average annual rate of 15% between 1955 and 1962. They further estimate that while this indebtedness increased about 2-1/2 times (from $7 billion to $18.2 billion), the debt service charges on it increased by almost 4 times (from $700 million to $2.4 billion) and are continuing to grow much more rapidly than the export receipts necessary for meeting them.

Lack of coordination of aid efforts among aid donors results in many inefficiencies, of which the potentially most wasteful and dangerous probably is unreported, uncoordinated, unregulated debt extension to the LDC's. The problem is of course made more intractable by the inherent data problems, for not even the LDC's know the total service charges on public and private indebtedness which will fall due at any one time. An international forum concerned with both developmental and commercial credits and the phasing of total service charges of each developing country is essential to prevent the present chaos from becoming disaster.
Memorandum

To: Walter W. Heller

From: Theodore Morgan

On: The Israel Less Developed Countries Financing Plan

October 12, 1964

This is a most interesting file, to which I react in part very favorably indeed, and partly with doubts. I put the doubts first, and support second.

Doubts:

1 - In several of the papers of Governor Horowitz (e.g., the UNCTAD address of April, 1964, p. 2) there is acceptance as fact that the terms of trade of LDC's have been falling secularly and also recently; and that this trend has injured them.

   a - I know that a long-run decline in the terms of trade of less developed countries has been accepted by them as an obvious fact. Yet this just isn't so. I have myself been persuaded by the empirical study of T. Morgan (Economic Development and Cultural Change, October, 1959) of which by chance there is an extra copy on hand, which I enclose. Jumping over the long-run pattern, with which the article is concerned: it is true that during the 1950's, and especially following the Korean war boom, the terms of trade of the less developed countries fell significantly, whereas the terms of trade of the developed countries were about stable. But if you change your base year, you get a different picture: since just before World War II, the terms of trade of the less developed countries have risen sharply, while once again those of the developed countries have not changed much.

   Individual commodities have repeatedly shown great variety of experience, and primary commodities are much more volatile price-wise than secondary products. But if one is asked to make a single interpretation of the 1950's experience, it is, I think, that we have been seeing the downswing of the wars-induced price boom—and not any long-run trend. (This reasoning is spelled out more at length in Roy Harrod and D.C. Hague, eds., International Trade Theory in a Developing World, Proceedings of an International Economic Association meeting, ch. 3, pp. 52-95).

   b - A fall in the terms of trade is not necessarily a disadvantage. There is, instead, an optimum price that is to be desired. For example, a higher price may lead to a sharp fall in sales due to economizing by consumers, expanded output from other producers, replacement by substitutes, replacement in the longer-run by new products developed by a resourceful technology responding to the price incentive.

2 - Dr. Prebisch's theory as to why there is the alleged fall in terms of trade of LDC's, which seems to be accepted here, has had a very mixed reception from his fellow economists. His views have changed their assumptions and pattern of emphasis and analysis repeatedly since their first statement in 1949. The necessary assumptions for a given statement are very restricted and often very much subject to question as to their empirical validity.
The Prebisch theory is only one among many in the field. I have counted 18 different statements from various economists, among which are almost as many different views. My own conclusion is that there are various influences on price trends for individual primary commodities, as for commodities in general, and that no simple generalization can account for the widely heterogeneous experience.

3 - Is it true that "the only way to narrow the gap between the developed and developing nations is by industrialization and diversification of the economies of the emergent nations"; and that "this objective can be obtained only through immense transfer of capital on a scale that would allow a break-through to self-sustained growth"? (op. cit., pp. 4-5).

a - Industrialization is in fact now proceeding at a rather fast clip throughout many under-developed economies, often at a 7 to 8% a year rate of advance. Where there is dubious success or failure, in mixed and communist countries alike, is in agriculture. In general in the low income countries, the poor cultivator in the field "without skills or knowledge, leaning terrifically against nothing" continues unproductive, isolated from the modern world. Perhaps we should be more concerned with agriculture, where the blocks to growth are greater?

b - Diversification diminishes the risks of market and production fluctuations; but the planners and/or businessmen should be very sure they are not diversifying into less productive uses of resources. Else they are choosing to become poorer normally to avoid becoming poorer occasionally.

c - And a world policy of huge transfer of capital to low income countries invites a huge amount of waste. A good deal of waste can be accepted as a necessary concomitant of effort and experiment; but much can be avoided, and certainly every project should be thoroughly scrutinized.

d - If scholars like Schultz (Presidential Address, American Economic Association, in its Review, March, 1961), Hagen (On The Theory of Social Change), and Sinai (The Challenge of Modernisation) are even partly right, growth policy should be focussed in very large measure toward changing and improving peoples' skills, health, general education, morale, their technical knowledge, and their value systems--so that these favor growth. Such a view shifts emphasis away from maximizing financial support for increasing physical capital, and raises more subtle and far-reaching issues.

Such a view fits in with the World Bank's complaint of not finding as many good projects as it now has resources to finance. The under-developed countries are not very sympathetic with the Bank's complaint, but it may still be partly right... Such a view would explain Israel's highly successful per capita growth in recent years--6% per year, 1957-62--not so much on the basis of capital inflow, as on the basis of the quality of immigrants, effective social organization, high morale, etc.

4 - Loans are now flowing to less developed countries at a rate so much faster than their income growth that a greater proportion of gifts-to-loans seems necessary at some time in the future, if net aid is not to shrink. The IBRD estimate of a rise of external public and
public guaranteed medium and long-term debt of 15% a year, 1955-1962, while gross income was rising among the more successful of the less-developed-countries at 4-5% a year. Interest charges have been increasing still more rapidly than debt.

"Unreported, uncoordinated, and unregulated debt extension" by the less developed countries is a genuine and important worry, as Mrs. Thumberg's memorandum indicates; and an international forum on development and commercial credits is very much needed.

If the present trend of rapidly increasing amortization-and-interest charges continues, widespread renegotiation (concealed default) and open default seem highly likely in the visible future; and too much of these will dampen support for aid proposals among high income countries.

Warm support:

The above points are mainly secondary ones so far as Governor Horowitz' specific plan is concerned.

1 - The Plan is ingenious, not burdening the balance of payments of countries in a weak balance of payments position, lowering the interest charge on credits to the less developed countries, and providing increased financial resources.

2 - More fundamentally, Governor Horowitz is surely completely right in reasoning that high income countries could greatly increase the present flow of resources to under-developed areas. From my own figures, the present flow from the developed non-communist countries is about 7/10 of 1 per cent of their gross national product. The burden to them would be slight of doubling or tripling this flow. The increase would absorb only a part of the annual rise in their productivity.
Extract from a speech by Mr. Philippe de Seynes, Under-Secretary of the U.N. for Economic and Social Affairs, on the "Importance of the United Nations Conference on Trade and Development for the American Business Community" (October 1964)

...The interest of the Conference in the problems of financing stemmed obviously from its stated purpose of examining trade in the general context of development. But this interest was heightened by a growing anxiety generated by recent developments and movements in some sectors of opinion, lest the great undertaking of public international assistance, one of the most constructive innovations of the post-war world, might be subjected to a process of erosion. An apprehension was felt, and sometimes voiced, that the flow of funds towards the under-developed countries might be slowing down, not only in relative terms, as a proportion of growing national income in the developed countries, but even in absolute terms.

There was also a feeling, insistent, although as yet insufficiently documented, that certain rigidities, deficiencies or at least inadequacies, existed in the institutional system of international finance which prevented the maximum of available resources from being effectively mobilized and channelled towards the fulfilment of the needs of developing countries. There was the recognition of certain distortions in the pattern of international finance such as the excessive development of short-term credit resulting from the fierce competition among exporters of equipment - which has considerably aggravated the indebtedness of certain countries over recent years.

Hence the desire, so manifest in the Final Act of the Conference, to investigate this whole range of problems as thoroughly as the area of trade policies had been investigated over the last two years. It is to be expected that the next Conference to be held in 1966 will be largely focused on matters of international financing.
Typical of this interest is the attention given to the problem of international liquidity. Its relationship with long-term economic development is not as yet very clearly identified, but, there is a growing realization that preoccupations with balances of payments, which could be alleviated through a new approach to the problem of international liquidity, are exerting a restraining influence on the total amount of funds available for economic development, that they are partly responsible for an increasing recourse to the technique of tied-loans which, in turn, result in a quite considerable increase of the cost of development, as receiving countries are barred from making use of the most advantageous opportunities. It is also quite probable that schemes which have been from time to time suggested to link the handling of the problem of liquidity with the creation of funds for development will receive increased attention.

One of the most interesting proposals made at the Conference—and one which received wide support from developing as well as developed countries—was that presented by Mr. David Horowitz, President of the Bank of Israel.

Mr. Horowitz's approach is directly inspired by the realization that exclusive reliance on foreign private capital in its traditional form, on the one hand, and public international aid through budgetary contributions on the other hand, are likely to be insufficient to raise the amount of real resources which could be mobilized for development in the less developed countries without contributing to world-wide inflation. Remarking on the success and relative facility with which the IBRD has been raising funds on the free financial markets of the world, and on the fact that the Bank is in a very liquid position, he advocates a greater transfer from the free financial markets to developing nations through the medium of the International Development Association (IDA). IBRD would raise funds through the floating of bonds, the proceeds of which would be remitted to IDA and lent by it to the developing countries at its usual conditions of loan, namely with a charge of one per cent. The difference of interest between this charge and the rates paid by the IBRD would be covered through an "Interest Equalization Fund" which itself would be established and maintained from grants by the industrialized nations or surplus profits of the IBRD. Thus, the scheme would require relatively small budgetary contributions, which would have a multiplier effect. It is to be noted that there is nothing in this scheme which suggests any
loosening of the disciplines which are at present applied by IDA or other lending agencies in respect of the preparation of well-conceived projects and programmes, nor is there any lack of awareness of the defects and weaknesses in the policies so often followed by the developing countries, and the imperative need to make a beginning towards correcting them before they can become eligible for financing.

At the present juncture, schemes of this sort must be studied in all their implications, for international financing of even the most credit-worthy nations is now frequently severely jeopardized by their existing indebtedness, and can only be envisaged on the required scale through the type of loans which IDA provides. It is also quite conceivable that greater availability of capital may be a strong inducement for developing countries to embark on the proper domestic policies.

It would be strange if the last word in development policies had already been said, and if all that remained to be done was to apply the prescriptions evolved over the last ten years.

It is quite clear that the United Nations Conference on Trade and Development has already served to accelerate the promotion of new ideas. That its effect has been felt in circles much wider than those of which traditionally the United Nations is the centre, was made manifest, for example during the Tokyo meetings of the International Monetary Fund and of the International Bank for Reconstruction and Development. This in itself is an achievement from which the United Nations can only benefit. Even an Organization of 112 members can become "inward-looking", if it is content with operating in the relatively closed circuit of its usual clientele and if it fails to enter in meaningful relationships with groups which are instrumental in the process of decision-making.

Interest, sympathetic interest, of the business community at the present juncture is essential to the formulation and implementation of new policies. There remains, on both sides, too much ignorance of the others' outlook and attitudes, and too many misapprehensions, for us not to give high priority to developing a fruitful relationship.

It is in this context that the Bankers Trust Company must be thanked for its constructive initiative in convening this
TO: Mr. R. Demuth, Development Services
FROM: John M. Garba, Executive Director
DATE: January 22, 1965
SUBJECT: The Horowitz Proposal "Development Financing Plan."

The question of the volume of capital outflow to developing countries in sufficient magnitude is relevant to the peculiar circumstances obtaining in individual capital importing countries. The terms on which such capital can appropriately be provided to meet this urgent and complex need of developing countries depend equally upon an admixture of circumstances no less formidable. Yet, each peculiar circumstance is inexorably interwoven with the other that an objective assessment is not possible without drawing a parallel of the one to the other.

Thus, the following questions at once become apparent, namely: 1) What circumstances are relevant? 2) What are the value judgements of significance which are involved in an analytical assessment of the variables leading to a choice of the right decisions? and 3) To what magnitudes should these circumstances be allowed to grow without the provision of remedy?

Obviously, the Horowitz proposal under consideration has in view just such questions and their magnitude and seeks the right answers, which, unfortunately do not lend themselves easily to definitions.

However, it is necessary that we recognize the fact that the principles of economics most clearly applicable to developing countries demand a formula which takes into consideration the visible needs and valid efforts of developing countries to find a panacea to the trade gap, balance of payments vulnerability, debt servicing difficulties, declining market prices, foreign exchange problems, availability of credit and terms of trade, all of which variables are interrelated one to the other and impinge upon the supply of capital and terms of trade, the solution of which, we think is not an easy one. Yet, when we view these realities facing developing countries against a background of the constriction of credit on the one hand, and restriction of investment capital, or its limitation on the other, one is indeed alarmed at the resulting dilemma of the developing countries, to say the least.

We are then driven to invoke the words of the prophet Isaiah: "Come let us reason together". And if nations, like individuals, have "their moments of truth", it is unmistakably clear that the future of
developing countries lie in a precarious balance, awaiting an adjustment of the capital market, terms of trade and an attitude of accommodation on part of the developed countries.

In this regard therefore, we think that part one countries might be called upon to a) voluntarily raise the level of their annual subscriptions to IDA on some agreed basis following the example of Sweden; also b) lend to IDA on IDA-type terms to supplement IDA's resources to a predetermined level within the order of magnitude compatible with the needs of part II members, or the proposed level thus combining proposals b) and c) of the Horowitz proposal. This combination we think, avoids the more costly and cumbersome aspects of the proposal, all of which have been adequately discussed in the analysis of the Bank staff, which might meet with the objections of some part one countries and the capital markets of the World.
OFFICE MEMORANDUM

TO: Mr. Richard H. Demuth
FROM: Joaquin Gutiérrez Cano
SUBJECT: Horowitz Proposal

DATE: January 22, 1965

In connection with the very interesting comments of the report on the Horowitz Proposal, I would like to express my identification with the difficulties and problems raised by the proposal.

Although I do not know the position of all the countries I represent, some of them have expressed their views in a way which goes along with the report. The points which were considered as of the highest importance are the following:

1. That the bonds issued by IDA should always be in such conditions and amounts which would not harm the normal development of the international capital market.

2. IDA should in its operations keep close interdependence between the terms of its borrowing and of its lending, regarding the duration of the credits. The problems of a refinancing of IDA's debts should be avoided.

3. In the event of the establishment of an "interest equalization fund", the contributions to it should primarily come from the Bank's net earnings instead of from the countries.
I have made inquiries about the position in regard to the Horowitz Plan and I understand that the position is as follows:

a. The report will be submitted to the United Nations as soon as practicable after the expiry of the date set when the draft was circulated to the Executive Directors, viz., January 22.

b. All comments received will be considered carefully and depending on what these comments are, changes may or may not be made in the draft.

c. The comments of Governor Horowitz will, of course, be taken into account along with the others.

cc: Mr. Demuth
January 8, 1965

Governor David Horowitz
Bank of Israel
Jerusalem, Israel

Dear Governor Horowitz:

Thank you for your letter of January 1, enclosing your comments on the Bank staff report on the proposal you made at UNCTAD. I appreciate your cooperation in sending them on so promptly. As you requested, the comments are being given to the Executive Directors together with the staff report.

I may add that we are not neglecting the broad economic aspects of the problem of the transfer of resources, to which your remarks refer. As I reminded the Executive Directors when making the report and your comments available to them, these aspects are being dealt with in other studies being prepared by the staff: a report on the proposal for "Supplementary Financial Measures" submitted to UNCTAD by the United Kingdom and Sweden, and other studies related to the developing countries' external capital requirements and, more particularly, the need for additional IDA resources. This work in progress is in fact mentioned on pages 2 and 4 of the staff report on your proposal. I can assure you that we shall be taking into account in these studies the concerns you have expressed.

With kind regards,

Sincerely yours,

(Signed) George D. Woods

George D. Woods

S. Boskey/mar
Jerusalem, January 1, 1965

Mr. George D. Woods, President
International Bank for Reconstruction
and Development
Washington, D.C. 20433
U.S.A.

Dear President Woods,

As promised, I am sending you enclosed herewith my remarks to the report of the Committee which dealt with the Horowitz Plan.

I shall be pleased to give in writing any further explanations, if such should be required.

With kindest regards and best wishes for a happy New Year.

Sincerely yours,

D. Horowitz
1. First, I would like to express some doubts as to the general approach of the Committee to the problem of mobilization of resources for the IDA, with a view to expanding and accelerating assistance to the developing nations.

In modern economics we are aware that what counts are real resources, and that the financial façade represents only a reflection of these real resources. The approach to the problem of transfer of resources should be first and foremost one of economic analysis dealing with real resources, and the financial technicalities could follow such an analysis. At least equal weight should have been given to both aspects, while the report deals exclusively with the financial technicalities.

One of the main reasons of the inability to deal with the economic crises of 1929 in the United States and in the thirties in the world was the exclusive concern with the financial façade which concealed the real problem of material resources. However, since the later thirties, we are aware that the financial pattern must be viewed from the point of view of material resources and subjected to this supreme test. Barring this departure in modern economics, we would be still deeply immersed in a world economic crisis and the economic conditions of the nations of the world affected by the Second World War would never have been restored, as they were through the Marshall Plan.
From the point of view of exclusively financial considerations, the establishment of the IBRD at a time of pent up demand and shortage of material resources after the war would have been utterly impossible and undesirable.

The challenge presented by the Horowitz Plan is, of course, of incomparably lesser difficulty and against a background of resources which are a multiple of what they were twenty years ago. The GNP of the developed nations in 1964 is estimated at some $1,050 billion, or even slightly more. The Plan is projected for a period of five years and with a growth average rate of 3 per cent per annum, which is a very conservative one; considering the more rapid pace of growth in Europe and the United States, it would amount in five years to some $1,200 billion. These are the most conservative figures and the growth is calculated at the rate of 3 per cent only. The amount envisaged in the Horowitz Plan is $600 million per year, which represents one-twentieth of one per cent of the GNP of the developed nations.

It is inconceivable that an annual issue of debentures of, let us say tentatively, $300 million in America, and $300 million in Western Europe, Japan, New Zealand and Australia, should be impossible. That would mean an order of magnitude of $40-50 million in a country like the United Kingdom or West Germany or France, particularly so as these countries are in a process of accelerated growth and such amounts would represent a declining percentage of their GNP. It is inconceivable that the ingenuity of financial management should be unable to find a method of diverting such a negligible proportion of resources if there is a real will and conviction that the project with which we are dealing is essential and of high priority.

Therefore, the economic aspect should have been taken into account and dwelt upon in its broad aspects. This would also conform with the resolution adopted by the U.N. Conference on Trade and Development, which reads as follows:
The Conference recommends that a further study be made by the International Bank for Reconstruction and Development covering all aspects of the proposal and taking into account the points and observations made during the discussion in the Third Committee.

2. As to the financial market for such bonds, the whole problem may boil down to an increased Interest Equalization Fund, in order to pay a higher price for money raised for the IDA. Anyhow, the Interest Equalization Fund is negligible and represents a marginal amount and a slight increase in this allocation should not be decisive.

The Committee and the management of the IBRD and the IDA assume that certain amounts will be allocated within the next years by the governments of the developed nations to the IDA and that the World Bank will allocate about $50 million per annum from its profits. Evidently the use of these funds as an Equalization Fund, with its multiplier effect, can provide a substantially larger transfer of resources through the IDA to the developing nations than these amounts themselves.

Moreover, the payment of interest from the Interest Equalization Fund to the bondholders remains within the confines of the developed nations and does not represent a burden on these nations through transfer from the developed to the developing nations. As these amounts are paid to the bondholders, they are not transferred at all. There may be a case for some small adjustment.
between the developed nations themselves, so as equitably to distribute the burden of the Interest Equalization Fund. Anyhow, there is no bearing at all on the balance of payments between developed and developing nations.

The American government recognized the high priority for such mobilization of funds by exempting the developing nations from the tax otherwise imposed on capital raised on the U.S. capital market.

3. The Committee dwells on apparent discrepancies between my statement in Geneva and the concrete proposal submitted to the Committee. The difference is, of course, between objectives of a certain policy projected on a long-term basis and a plan for its initiation. When the IBRD was established, there may have been a vision of a large scope of activities. However, the initial scheme was limited by the experimental character of the daring venture and immediate possibilities. The same applies to the Horowitz Proposal, and the projection of future possibilities as presented to the Geneva conference, which may or may not materialize, does not prove a contradiction with the practical, immediate, operative plan which, of course, must be much more modest. This, of course, does not mean that the initial plan must be again whittled down to negligible proportions.

4. The present conditions are particularly propitious to the materialization of such a plan, with armament expenditure declining, perhaps even absolutely, and certainly relatively to the GNP, owing to the point of saturation of modern overkill capacity, there may be substantial reductions in military
budgets relatively to the national income and substantial underemployment of physical and material resources and capacity of production. Much research is undertaken to deal with this problem and the dovetailing of the two problems – one of assistance through the IDA and the other of reduction of military budgets which may lead to underemployment of manpower and resources – would be expedient and possible.

5. The report gives absolute and unchallenged priority to the IBRD in comparison with the IDA. This positive bias towards the IBRD conforms very well with the established routine. However, the economic priority should be based on the actual exigencies of the situation and always be subjected to the supreme objectives of a certain activity. Both the IBRD and the IDA are instruments for the promotion of development of developing nations. The IBRD discharged in this field a pioneering task. However, there is little doubt that from the point of view of effectiveness of promotion of economic growth in the developing world, the IDA should be given at the present juncture at least equal weight.

The attitude that the IBRD should not make any allowances for the IDA activities which would in any way or to any extent affect its own activities has already been invalidated by the decision to allocate part of the profits of the IBRD to the IDA. However, this overconservative attitude, which subordinates the interest of the IDA in all cases and under all circumstances to the IBRD, does not seem to us to meet the needs of the present situation in the developing world.
6. The Horowitz Plan has the advantage of political attractiveness, with the general tendency to tap private resources for assistance to underdeveloped nations and to refrain from increased claims to parliaments to augment budgetary allocations.

7. The problem is one of alternatives. What is the alternative to a breakthrough in the developing nations, against the background of the political situation in Africa, Asia and Latin America? With pedestrian means, these problems are insoluble. The question is one of priorities. If the project is a high-priority one, the apparent difficulty of some technicalities can be overcome. It would have been unimaginable 50 years ago that income tax, which was considered as a most revolutionary departure, would assume present dimensions in the developing nations.

Of course, it was never claimed that the Horowitz Plan is a panacea and a monopoly, but it may be considered, in the present circumstances, as a practical plan to a substantial expansion of assistance to developing nations on realistic terms, with a relatively minor allocation from budgetary resources.

December 31, 1964

D. HOROWITZ
THANKS YOURS DECEMBER 21. REGRET MISUNDERSTANDINGS, AS I DID NOT EXPECT DIRECTORS "APPROVE" CONTENTS OF STUDIES NOR DISCUSSION REPORT WITH EXECUTIVE BOARD. HOWEVER INTERESTED INFLUENCE COMMENTS OF DIRECTORS TO BANK STAFF BEFORE SUBMISSION TO UNITED NATIONS AND OPPORTUNITY STATE MY CASE BOTH TO BOARD MEETING AND STAFF. SEEING LITTLE PROSPECT MODIFICATION POST FACTUM AND INTERESTED ELUCIDATING MY POINTS TO DIRECTORS WHICH MAY BE USEFUL FOR THEIR COMMENTS TO STAFF. UNDERSTOOD OUR WASHINGTON CONVERSATION IN AUGUST THIS WOULD BE THE PROCEDURE. BELIEVING THAT DIRECT CONTACT WITH STAFF COULD ELUCIDATE SOME POINTS BEFORE SUBMISSION REPORT HAVE LITTLE FAITH WRITTEN COMMENTS WITHOUT EXCHANGE OF VIEWS. REGARDS AND WISHES NEW YEAR

HOROWITZ
OUTGOING WIRE

TO: HOROWITZ
GOVERNOR
BANK OF ISRAEL
JERUSALEM

DATE: DECEMBER 30, 1964

CLASS OF SERVICE: IBF GOVT.

COUNTRY: (ISRAEL)

TEXT:
WOODS AGREEABLE CIRCULATING YOUR COMMENTS TO EXECUTIVE DIRECTORS WITH REPORT. HOPE YOU CAN SEND THEM PROMPTLY. REGARDS

DEMUTH
INTBAFRAD

NOT TO BE TRANSMITTED

MESSAGE AUTHORIZED BY:

NAME
Richard H. Demuth

DEPT.
Development Services Department

SIGNATURE
RHD:tf

FOR USE BY ARCHIVES DIVISION

ORIGINAL (File Copy)

(CHECKED FOR DISPATCH)
OUTGOING WIRE

DATE: DECEMBER 30, 1957

TO: HONORABLE GOVERNOR
BANK OF ISRAEL
JERUSALEM

COUNTRY: (ISRAEL)

CLASS OF SERVICE: IR UN

TEXT:

WOULD APPRECIATE CIRCULATING YOUR COMMUNITY TO EXECUTIVE DIRECTORS WITH

REPORT. HOPE YOU CAN SEND THEM PROMPTLY.

REGARDS,

DEPARTMENT

INTEREAD

NOT TO BE TRANSMITTED

MESSAGE AUTHORIZED BY:

DEPARTMENT:

DEPARTMENT SERVICES

INSTRUCTIONS: INDIVIDUAL AUTHORIZED TO APPROVE

NAME:

INFORMATION:

FILE:

RECEIVED:

FORWARDED:

CHECKS FOR DIRECTOR

IMPORTANT: SEE GUIDES FOR PREPARING FORMS
TO: HOROWITZ BANK OF ISRAEL JERUSALEM

DATE: DECEMBER 28, 1964

CLASS OF SERVICE: IBF GOVT.

COUNTRY: (ISRAEL)

TEXT:

REURGAB WHILE CONTINUING OF OPINION THAT YOUR APPEARANCE BEFORE EXECUTIVE DIRECTORS INAPPROPRIATE PRIOR TO SUBMISSION REPORT TO UNITED NATIONS WOULD VERY MUCH LIKE TO HAVE YOUR COMMENTS ON TEXT STOP DEMUTH MUST BE IN PARIS FOR MEETINGS MIDDLE FIRST WEEK IN JANUARY AND WOULD BE PREPARED ARRANGE EARLIER ARRIVAL IF YOU COULD MEET HIM THERE STOP SUGGEST YOU FLY PARIS AT BANK EXPENSE FOR DISCUSSIONS WITH DEMUTH ON TUESDAY JANUARY SIX CONTINUING IF NECESSARY MORNING JANUARY SEVEN STOP INVITATION INCLUDES MRS HOROWITZ STOP WOULD APPRECIATE IMMEDIATE REPLY BY CABLE REGARDS

WOODS INTBAFRAD
OUTGOING WIRE

DATE: December 28, 1975

TO: Bank of Israel

Prudential

Cables (Israel)

TEXT:

Rush your cables while continuing with opinion that your appearance report
executive directors important prior to submission report to united
national company would rely much upon your comments on my report
which must be in Paris for meetings mid-week first week in January and
would be performed arrival earlier arrival if you could meet him there.

Suggest you fly Paris at bank expenses for discussions with director
on Tuesday January 3 as continuing in necessary morning January 4.

STOP

Reply by cable

WOODS

INTERNATIONAL

NOT TO BE TRANSMITTED

MESSAGE AUTHORIZED BY:

CABLES AND COPY DISTRIBUTION

DE 29 6/41 1975

George D. Woods

Permit's Office

Signature

(Seal and official authorized to arrange)

(Original) (For Copy)

NATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
December 21, 1964

Governor David Horowitz
Bank of Israel
Jerusalem, Israel

Dear Governor Horowitz:

Mr. Demuth has shown me your letter of December 14, written after you had received and read the draft Bank staff report on the proposal you made at UNCTAD.

The letter confronts us with a dilemma. It has been my understanding with the Executive Directors of the Bank, and it was so stated by the Bank's representative at UNCTAD, that any studies made by the Bank in response to requests from UNCTAD would be staff studies. That is, while the studies would be made available to the Executive Directors before being submitted to the United Nations and while the Executive Directors would have an opportunity to give comments on them to the Bank staff, the Directors would not be asked to "approve" the content of the studies nor would the texts purport to represent the views of either the Directors or the Bank's member governments. Accordingly, there is no plan to schedule a discussion by the Executive Directors of the report on your proposal prior to its submission to the United Nations. There may well be a later discussion in our Board, in addition to whatever discussions may take place in various United Nations bodies, after governments have had an opportunity to consider the issues pointed out in the report. But I do not believe that consideration by the Executive Directors of the merits of the proposal would be appropriate now.

In the circumstances, I would like to suggest the following. We should be very glad to have any written comments you care to make on the report as it stands, to improve its accuracy or clarity within the framework of the staff approach. These comments, should you wish to make them, ought to reach us fairly soon, by the end of December if possible. As you know, we told the Secretary-General in August that we expected to be able to submit a report by the end of the year and we would hope not to miss that date by very much. Then, after the report has gone to the United Nations and is in the hands of governments, we should be glad to arrange for you to make a presentation to the Executive Directors on the merits of the proposal which governments may take into account in considering what action to take. This presentation could be scheduled at your convenience.
I should very much appreciate your cabling me whether this suggestion meets with your approval and whether we may expect written comments from you soon.

With all good wishes for the New Year,

Sincerely,

(Signed) George D. Woods

George D. Woods
December 16, 1964

Mrs. Shirley Boskey
Development Services Department
International Bank for Reconstruction and Development,
1818 H Street, N.W. Washington D.C. 20403

Dear Shirley:

Thank you very much for your kind letter of December 7 and the excellent summary of the talks with our bankers. It is a very precise and clear account on these interesting discussions, which, as I have learnt since I saw you, were greatly welcomed by many of the bankers who were present. The more I think of it, the more I feel that raising money under the Horowitz proposal should be done outside the usual I.B.R.D. borrowing operations. As conditions are presently, a well-publicized world-wide issue managed by an enlarged syndicate of leading banks in capital exporting countries would have a better chance of attracting private and institutional funds than small separate issues which would tend to be costly and more difficult to manage.

This is only a personal opinion, of course, and one which I voiced on our last two meetings in London.

I am looking forward to your draft report and send my best wishes for every success in this important venture.

Sincerely yours,

Robert de Lesseps
Jerusalem, December 14, 1964

Mr. Richard H. Demuth, Director
Development Services Department
International Bank for Reconstruction
and Development
Washington, D.C. 20433
U.S.A.

Dear Mr. Demuth,

Many thanks for your letter of December 2, to which I am replying only today as I was anxious to study first the document which you were so kind to send me.

Before reading the document, I intended to let you have my comments in writing. However, after a thorough study, I changed my mind and I would rather submit my remarks in person.

However, I would embark on this rather inconvenient and difficult trip only if I would be assured that I could present my case not only to members of the committee, but also to the Board of Directors of the I.B.R.D.

I shall be much obliged for your early reaction to this letter and your proposals on how we shall proceed in this matter.

With kindest regards,

Yours sincerely,

[Signature]

Ack. Dec. 21, 1964
December 7, 1964

Mr. Robert de Lesseps
4, Avenue d'Iena,
Paris 16e,
France.

Dear Robert:

I dare say that by now you have concluded that I simply forgot all about my promise to send you a copy of whatever notes I produced on our various interviews with European bankers. As you will see from the enclosed, I didn't forget; I simply put off doing them up. I hope they will be of some use, or at least of interest, to you.

We are expecting to have a Senior Staff Meeting discussion on a draft of the report in about ten days, so we may at last be close to the end of this very long production.

Thank you again for all your helpfulness, and good wishes for the holiday season.

Sincerely yours,


Shirley Boskey
Development Services Department

SBoskey/jk
OFFICE MEMORANDUM

TO: Files
FROM: Shirley Boskey
DATE: December 7, 1964
SUBJECT: Market Operations Aspect of the Horowitz Proposal: European Views

Between November 7 and November 17, Messrs. Friedman and de Lesseps and I, on occasion joined by Mr. Miller, had discussions with a number of private bankers and with officials of central banks and ministries in Zurich, Amsterdam, Paris, Frankfurt and London concerning the feasibility of borrowing for IDA under the terms of the Horowitz proposal. These discussions were arranged to provide data on the basis of which the Bank staff report on the proposal, being prepared for submission to the Secretary-General of the United Nations, might offer an impression of the attitude of European financial communities.

Attached are notes on the comments made to us in the course of the various interviews. They were made against the background of a paper (copy attached), sent in advance of our meetings, summarizing the proposal and posing certain questions. For the most part, the notes do not attempt to assign particular comments to individual participants in the discussions.

cc: Messrs. Friedman
de Lesseps (European Office.)
MARKET CONSIDERATIONS RAISED
BY THE HOROWITZ PROPOSAL

The International Bank has been asked by the United Nations Conference on Trade and Development (UNCTAD), meeting in Geneva, to study and report to the United Nations on a "Development Financing Plan" submitted to UNCTAD by the Delegation of Israel, led by Mr. D. Horowitz, Governor of the Bank of Israel. The plan, referred to in this memorandum as the "Horowitz Proposal" and described in some detail below, has as an essential element the raising of funds in the private capital markets of the developed countries. The Bank therefore considers it desirable and important that its analysis of the proposal and its report to the United Nations take account of and record the reaction of representatives of the financial markets of the United States, the United Kingdom and Europe to the proposal, with particular reference to the borrowing feature.

This memorandum has been prepared to serve as a basis for exploratory and informal discussions between Bank officials and representative leaders of the financial community in several capital-exporting countries. Following a brief description of the principal elements of the proposal, the memorandum sets forth certain questions relating to the proposal. These questions have been framed, not for the purpose of eliciting categoric replies, but rather to invite and provoke consideration primarily of (a) the feasibility of the approach contemplated, insofar as the market aspects are concerned; and (b) the implications for the Bank/IDA should either become associated with the proposal.

The Proposal

Two basic premises underlie the proposal: first, that a satisfactory rate of economic progress for the developing countries depends upon capital inflows in amounts much larger than have hitherto been available and on terms appropriate to the recipient countries' repayment capacity; and second, that it is not politically realistic to expect development assistance on the scale and terms required to be made available through direct budgetary allocations.

To avoid the necessity of relying primarily on budgetary appropriations for the large amounts of development capital postulated to be required, the proposal contemplates that the funds be obtained from the private capital markets of the developed countries. The technique would be as follows:

(1) The International Bank, the International Development Association (IDA) or some other international institution would borrow funds on commercial terms from private investors. If the borrower is the Bank or some other international institution, and not IDA, the funds borrowed from the private market would be re-lent to IDA on the same terms on which they were raised.
(2) The borrowing in the private market would be made possible by a special system of government guarantees in which all of the industrialized countries which are members of IDA (i.e., the "Part I" countries) would participate, each in a proportion based upon its quota in the International Monetary Fund or upon its subscription to the capital stock of the Bank. The government guarantees would apply directly to the market borrowings or, if the Bank or some other international institution should be the borrower, might alternatively apply to loans by the borrower to IDA of the proceeds of the market borrowings.

(3) In order to reduce balance of payments constraints on the level of multilateral development aid, borrowing operations would be conducted to the extent feasible in those countries which, at the time, had a balance of payments surplus.

(4) The funds raised by the borrowings would be lent by IDA on "soft" terms.

(5) The difference between the market cost of borrowing, on the one hand, and the charges on IDA credits made out of the borrowed funds, on the other, would be met out of an "interest equalization fund" to be created and maintained by the industrialized countries, each country to assume a proportionate share of the annual aggregate, allocated on the same basis as the guarantee liability.

As presented to UNCTAD, the proposal contemplated market operations in the order of $2,000 million a year over a 10-year period. Governor Horowitz subsequently suggested that the target should be lowered, to an aggregate of $3,000 million of borrowings over a period of five years. He envisages that loans out of the borrowed funds would be made for periods up to 30 years, with interest at 1%, and that there might be a 4% differential between this charge and the cost of borrowing, to be met out of the interest equalization fund.

Questions Raised by the Proposal

The Bank is particularly interested in having the views of representatives of the financial community on the following questions:

1. In what circumstances and under what conditions would the markets of the developed countries be able and willing to supply funds as contemplated by the Horowitz proposal?

(a) What kind of government guarantee would be required? Would a system of "several" guarantees (under which each government would guarantee only a specified proportion of each borrowing or of each loan to IDA) suffice? Would a system of joint and several guarantees (under which each government would be independently liable up to a specified amount) be necessary?
(b) How much is it likely to cost to borrow for purposes of the proposal?

(c) Is the order of magnitude of borrowing contemplated by the proposal realistic in terms of the absorptive capacity of the markets concerned? If not, what order of magnitude would be?

2. The Bank staff estimates that over the next five years, the Bank will require about $1,400 million to meet bond maturities on outstanding borrowings and an estimated $4,000 million to meet disbursements on its loans, a total of some $5,400 million. Some part of this total will be financed through loan repayments, sales of loans, income, etc. But after account is taken of these sources of funds, there will remain some $3,000 million to be raised by borrowing, an average of $600 million a year over the five-year period. Is it reasonable to expect that capital markets of the developed countries could, or would be prepared, to absorb, annually, an average of some $1,200 million of borrowings for the Bank and IDA combined (of which about $900 million would be "new money", i.e., over and above the estimated amount of repayments on outstanding obligations)? Would borrowing for IDA, within the framework of the proposal, be likely to affect the Bank's ability to meet its own need for borrowed funds? Would it be likely to raise the cost of borrowing for future Bank operations?

3. Would Bank participation in the scheme, as borrowing agency, be likely to have an adverse effect upon its credit standing? Would it be likely to affect the Bank's ability to borrow or attract participations?

4. If, by reason of a default on an IDA credit made out of funds borrowed by the Bank, IDA were not in a position to repay a loan from the Bank, would this circumstance be likely to have an adverse effect on the Bank's market standing, even though bondholders were fully protected by the special system of government guarantees?

5. Would there be any advantage or disadvantage from the standpoint of the Bank's future relationship with the market if IDA, rather than the Bank, were to borrow for itself directly?

October 1964.
I. SWITZERLAND

A. Credit Suisse

E. Lindegger, Manager
E. Hurter, Deputy Manager
H. Mast, Deputy Manager

The preliminary comment was made that it was at present the policy of the Swiss government to reserve for the Bank whatever funds could be raised in the market for international institutions. The Inter-American Development Bank, for example, has not been permitted to borrow. A change in that policy would be necessary before IDA could come to the Swiss market.

No specific estimate was offered of the amounts which might be raised in Switzerland, although it was said that any Swiss contribution to IDA's needs would necessarily be small. The Swiss market is accustomed to no more than 4-5 foreign issues a year, the average size of which is well below the size of some of the recent Bank issues in Switzerland. It would not be feasible to shift from budgets to capital markets as the source of IDA funds unless governments took steps to stimulate private savings. If the 1964 level of new foreign borrowing in all of Europe - some $400-$500 million - is any guide, it might be difficult to raise additional funds for IDA in the order of magnitude contemplated by Governor Horowitz, and as far as the Swiss market is concerned, borrowing for (or by) IDA would very likely be at the expense of the Bank. The possibilities for Bank borrowing might be slightly enlarged if the Bank's rate were raised, or if the Swiss government itself would guarantee Bank bonds issued in Switzerland.

Assuming a public issue, a system of joint and several guarantees would be necessary. Switzerland has had no experience with "several" guarantees (under which each guarantor government would guarantee only a specified proportion of each borrowing.) At the same time, Swiss investors view guaranteed loans with some suspicion, being inclined to regard the guarantee as a device to avoid appropriations. In any event, the prestige of the principal debtor would be the primary factor in the success of an issue. Because of the Bank's prestige, the guarantees built into the Bank's capital structure are considered a second line of defense; if, on the other hand, IDA were to borrow, the proposed guarantee system would be the first recourse of investors.

Assuming IDA were permitted to borrow in its own name in Switzerland, it would have to pay more than the Bank, perhaps 1/2% more. There is some doubt whether Swiss investors would take up an IDA issue at all, in view of the terms of IDA's own credits and the necessity, as mentioned above, of relying on the guarantees. Offering a higher rate is not the answer; indeed, the higher the rate, probably the greater the disposition of Swiss investors to shun an issue as too risky.

Apart from the fact that it might be necessary to raise the Bank's rate to enable it to borrow more, the mere fact of Bank borrowing for IDA is not
likely to have adverse consequences for the Bank initially. If, however, loans to IDA should come to account for a large part of the Bank's portfolio, or if IDA should default on a Bank loan out of borrowed funds, the Bank's credit standing might be impaired.

II. NETHERLANDS

A. Algemene Bank Nederlands

D. C. Renooij, General Manager
A. Batenburg, Deputy General Manager
A. F. J. Dijkgraaf, Managing Director.

It was estimated that 100 million guilders annually could be found for the Bank and IDA together, assuming no balance of payments difficulties, an adequate system of guarantees and government permission to borrow. At present, the country's net capital export objective is 600 million guilders. But whatever went to IDA would reduce what might otherwise be available for the Bank and other international organizations, such as the Coal and Steel Community. There is little possibility of enlarging the percentage of market resources available for foreign issues. Account has to be taken of the "digestive maximum", the point at which investors feel the proportion of international institution obligations in their portfolios is large enough. Perhaps if use of funds provided by Dutch investors could be tied to purchase of Dutch products, somewhat larger amounts might be attracted.

No specific borrowing rate was mentioned. If IDA were the borrower, it should not have to pay much more than the Bank, assuming that the market considered the system of guarantees adequate and the proposal was clearly presented. Some investor hesitation should be expected at the outset, however. In part this would be due to the newness of IDA as a borrower. In part it would be because investors would feel they were being asked to accept a double risk: (a) the risk associated with any international cooperative undertaking which relied on all participating governments to fulfill their obligations and (b) the risk associated with the long-term nature of IDA's own credits. This investor reaction could be expected notwithstanding that international agencies might well be the last to suffer defaults.

Two considerations are relevant for determining what system of guarantees would best assure the marketability of bonds issued in the context of the proposal: the quality of the guarantees should be no less than those associated with Bank bonds and the system should not be complicated. "Several" guarantees would be inadequate; "joint and several" guarantees would be satisfactory. Special rules govern the eligibility of investments for Dutch pension funds, trustees, insurance companies, etc., the bonds should meet these legal requirements to assure the widest possible market. It would be in the interest of governments to establish such a system of guarantees as would enable bonds to be sold at the lowest possible interest rate.

Should the Bank be the borrower, investors would probably not be concerned with the end-use of the borrowed funds, and would not be troubled by
the fact that some portion was destined for IDA. Nevertheless, if borrow-
ings for IDA were large and habitual, investors could be expected gradually
to evidence greater interest in the growth and condition of the Bank's
capital and reserves. Any default by IDA on a Bank loan made out of borrow-
ed funds would adversely affect the Bank's credit standing. (Some deteriora-
tion in the Bank's credit standing might in any case be the consequence of
some of the new policies recently announced by the Bank, including in particu-
lar the proposed loan to IFC, some of whose investments have encountered
difficulty).

B. Amsterdamsche Bank

Lammers, Deputy General Manager
C. D. Jongman, Director, Economic Department
A. V. den Gaarden.

Assuming that the central bank were to permit borrowing for IDA, some
50-100 million guilders of borrowing authority annually for the Bank and IDA
together, might be anticipated. Any borrowing for the purposes of IDA would
be at the expense of funds for the Bank, even assuming the market were open,
because the bonds of either institution would appeal to essentially the same
category of investor. Perhaps a higher interest rate might squeeze out a bit
more. It might also help to broaden the market if the approach to the mar-
ket were split - that is, if there were, say, two borrowings annually rather
than one. If the first issue were successful, repeated borrowings for IDA
could probably be envisaged. It would, however, be necessary to reckon with
investors' reluctance to hold more than a certain proportion of international
issues in their portfolios.

The Bank should be able to borrow at about the same rate as the govern-
ment. IDA, however, is likely, at least at the start, to be closer to the
position of a private borrower, largely because it is relatively unknown in
the Netherlands. It would probably have to pay 1/4 - 1/2% more than the Bank.
Borrowing at times of monetary restraint might mean a higher interest rate.
The simplest technique might be to have the Herstelbank, which borrows in the
Dutch market on a guaranteed basis, float an issue of which the proceeds would
be turned over to IDA.

"Several" guarantees would not be satisfactory to the market. It would
be necessary to have a system comparable to that which supports Bank borrow-
ings.

It is unlikely that the Bank's cost of borrowing would be increased
if it borrowed for IDA, solely because of the proposed on-lending. However,
it might be necessary to offer a higher rate as a means of attracting funds
in excess of the Bank's requirements for its own purposes. Bank borrowing
for IDA would not have an adverse effect upon the Bank's credit standing;
since IDA is little known in the Netherlands, investors would consider they
were dealing with the Bank. Even should IDA default on a Bank loan made
out of borrowed funds, if the defaults were neither large nor habitual there
would be no adverse consequences for the Bank's credit standing. Thus there
would be no particular advantage, in terms of the Bank's future relationship
with the market, in having IDA borrow in its own name.
Some scepticism was expressed concerning the practical possibilities of raising funds in the amount contemplated by the proposal, given the keen competition for existing long-term loan capital, and the fact that countries which are net importers of capital could be expected to be unenthusiastic about the proposal, as far as concerns their own participation. Quite apart from the question whether governments would be prepared to adopt the proposal as part of their national purposes and take appropriate steps to facilitate the raising of funds within the context of the proposal, investors have certain rules about the volume of international institution issues they will hold for a particular type of risk. For this purpose the Bank and IDA risks are very close.

The Bank might have to increase its rate slightly if it tried to borrow for IDA's needs as well as its own. For one thing, the proposed special system of guarantees of Bank loans to IDA is complicated and not easy to explain to investors. For another, the higher borrowing target might make it necessary to try to reach new investors. IDA's borrowing cost is likely to be about 1/4% more than the Bank's.

An IDA default on a Bank loan out of borrowed funds is likely to have little, if any, consequence for the Bank's market standing if the default can be adjusted internally; if the public became aware of the default, the consequences for the Bank would be adverse. In any event it is possible that, borrowing for IDA apart, the Bank's credit standing might be impaired by the new lending policies recently announced.

By and large, it might be better to have IDA borrow in its own name. This would not only minimize any possible impairment of the Bank's standing but might possibly increase the borrowing potential: the two institutions together might borrow more than the Bank alone.

The proposed basis for allocating guarantee obligations (and contributions to the interest equalization fund) among the Part I governments, i.e., on the basis of Bank subscriptions or Fund quotas, would be unacceptable to the Netherlands. Allocations should be based on IDA subscriptions, which bear some relationship to the subscribing country's real resources. In any case investors do not take the same view of government guarantees as they do of the uncalled portion of Bank subscriptions: they think it unlikely that governments would fail to respond promptly to a call on their subscriptions, but they are not so sure that governments would be as ready to honor a guarantee.
III. FRANCE

A. Ministry of Finance

M. Pierre-Brossolette, Deputy Director of External Finance
M. Carriere

The Ministry's first reaction to the proposal was that it is a kind of "trick". As a matter of principle, development aid offered on easy terms and over a long period should come from the budget. Governments are likely to be liable in the end, since there is a good possibility that the ultimate borrowers will default or that a debt readjustment will become necessary. That being so, governments should assume liability from the outset, by making funds available through the budget with an immediate impact on taxpayers. Even if the government raised aid funds by borrowing, the money might nevertheless be made available through the budget.

No figure was mentioned as a feasible French market contribution to IDA. The Bank itself, not being known as a borrower in France, might not find it easy to sell its bonds. It is unlikely that the government would permit the Bank to borrow the amounts indicated for IDA on top of its own needs, so that any borrowing for IDA would be at the expense of borrowing for the Bank's own operations. Control of the rate could be achieved through government control of the supply of issues.

If the system of guarantees is adequate and the interest rate satisfactory, French investors might not concern themselves with the proposed disposition of the borrowed funds. In that event, there would be no adverse consequences for the Bank by reason of its borrowing for IDA. But investors might look beyond the Bank, in which case account should be taken of the fact that there is a general popular impression that the projects which IDA finances, as well as the terms of its credits, are "soft". The Bank's lending policies have recently become more liberal; IDA's policies might likewise be relaxed, and it is conceivable that it might in future extend balance of payments credits, for example, as well as project loans.

A default by IDA on a loan from the Bank could be expected to affect the Bank's standing adversely. To minimize any adverse consequences for the Bank, it might be preferable for IDA to borrow in its own name.

B. Credit Lyonnais

Maurice Schologel, Deputy General Manager
M. Schietere

The most which the Bank can expect to raise in the French market, annually, is $30 million. An issue denominated in foreign currency might have a greater appeal for French investors, who already have a wide choice of franc issues. If it were possible to offer investors the option of being paid in foreign exchange, this might help to keep down the interest rate, although it would mean that the Bank or IDA would have to accept an exchange risk.
The Bank's cost could be expected to be about 5.7-6%. IDA, being less well-known than the Bank, would have to pay more. (No specific figure was suggested).

A bond carrying a multiple government guarantee would be less attractive to French investors than one guaranteed by the French government alone or even by another of the principal Part I governments. French investors would be concerned whether, under a multiple guarantee system (unless each government were willing to give full joint and several guarantees), each government would honor its obligation.

All things considered, it would be preferable if the Bank were to approach the market, although there is a possibility that borrowing for IDA could injure the Bank's standing. Bonds are more likely to be saleable if the guarantees are addressed to repayment of the Bank loans to IDA; then bondholders could look to the Bank, not to governments as they would have to do if IDA borrowed with governmental guarantees of its bonds.

If IDA were nevertheless to be the borrower, perhaps it might borrow with the guarantee of the Bank itself. Since the Bank now faces the problem of introducing itself to the French market, its first borrowing in France should be for its own needs. The next stage might be a borrowing by the Bank to cover its own needs and those of IDA. Once IDA became known, it might go to the market itself, with the guarantee of the Bank. Eventually it might be able to borrow with the guarantee of governments.

C. Banque de Paris et des Pays Bas  

B. de Margerie, Manager.

No estimate was made of the amount which the French market might be expected to provide toward the needs of both the Bank and IDA for borrowed funds, assuming/government permitted IDA to borrow. It is doubtful that the government would be willing to give IDA's needs a sufficiently high priority in the foreign borrower queue. Even though under the proposal budgetary appropriations to IDA would be eliminated, it is unlikely that an amount equal to what would have been appropriated could be borrowed; something would be lost in the transition from the budget to the capital market.

It might be easier for the Bank to approach the market in IDA's behalf rather than to have IDA borrow directly. Even though the Bank has not yet borrowed in France, its bonds have been given top rating, based on the Bank's standing as a borrower, rather than on the use made of borrowed funds. It is not certain that IDA bonds would be rated as highly. If not, IDA would have to pay more for its money than the Bank and this could have a detrimental effect on the Bank's credit standing. Moreover, if the Bank borrows for IDA, the government guarantees would then be a matter between IDA and the Bank; the investing public would not become involved.

It is unlikely that the Bank's credit standing would be impaired just because the Bank borrowed for IDA. Investors are inclined to assume that whatever the Bank does is well-thought through and responsible; they are not likely to be worried should the Bank lend to IDA. Moreover, Bank loans are normally made to or guaranteed by less developed countries, whereas under the proposal Bank loans to IDA would be guaranteed by the Part I countries; logically, therefore, the investing public should regard Bank loans to IDA under the proposal as more secure than a normal Bank loan.
D. Société Générale

J. Meary, Manager.

No estimate was made of the amount which the French market might contribute toward the needs of the Bank and IDA. It is not easy to sell foreign issues in France, particularly bonds of international institutions. The European Investment Bank and the Coal and Steel Community found that only limited amounts were available for them. The French investor has had disillusioning experiences with foreign investment, especially bonds floated to raise funds for the less developed countries. Such bonds had a better chance of success if the proceeds of the borrowing were ultimately destined for private enterprise and that fact could be made known. This is a relevant consideration when large issues are contemplated, since all but about 10% of any large issue is normally taken up by small investors; institutional investors take up the larger proportion of smaller issues.

International guarantees have less appeal for the French investor than a guarantee by the French government. The most desirable arrangement would be a French government guarantee running directly to the bondholder; the government could agree with other government guarantors concerning reimbursement for any pay-out it might have to make. With a French government guarantee, Bank borrowing for IDA would not affect the Bank's credit standing. The Bank's cost of borrowing would be about 1½% above the government's. If IDA borrowed in its own name, it would probably have to pay about 1% more than the Bank. It is unlikely to affect the volume of funds which might be raised whether the Bank or IDA borrows; neither is well-known to the small investor, who will follow the advice of the bond salesman with whom he is accustomed to deal and will neither care about, nor understand, the intricacies of the proposed guarantee system. It would, however, be useful and important to publicize the Bank's name and its activities in France.

IV. GERMANY

A. Bundesbank

O. Emminger, member, Board of Directors.

The original magnitude of the scheme is completely unreal. The revised target is much more realistic. However, the upper limit of borrowing in a single year for the Bank and IDA together in the German market is $100 million. It might be less if, as contemplated by the proposal, the Bank and/or IDA were to approach the market regularly and frequently. Any borrowing for IDA would be at the expense of the Bank, unless it were possible to offer very favorable terms which might attract insurance companies and pension funds, which do not usually take up foreign issues. It would be harder to sell dollar bonds than bonds denominated in deutsche marks.

It would be necessary to back the bonds with a system of joint and several guarantees; a several guarantee would not suffice. The interest equalization fund feature of the proposal might well prove attractive to investors, since in effect it would make the guarantee of interest operate automatically. This feature might give investors greater confidence and eventually it might be feasible to reduce the interest rate. On the other hand, the scheme could be seen as an invitation to default; the unusual
system of guarantees by the Part I governments might lead the Part II countries to view IDA credits out of the borrowed funds as loans by a consortium of governments, rather than by an international institution. The German experience with interest rate subsidies in housing and agriculture suggests that the subsidy contributes to keeping up interest rates.

Development aid ought to be provided through the budget; there is, however, sentiment in some departments of the German government for shifting the source of funds to the market, at least in part. The balance of payments surplus criterion for time and place of borrowing makes little sense. The German view is that the aid burden on the balance of payments must be accepted, along with tourism and other outflows. The few European countries which had a balance of payments surplus during all of 1964 could not themselves supply the amount of funds envisaged. Aid contributions should be related to a country's real resources, per capita income, etc., not based upon a fluctuating balance of payments situation.

As far as the choice of borrower is concerned, the market would be worried about any departure from orthodox Bank lending, as witness the critical press reception of the recent apparent "softening" of Bank terms. It is, however, possible that investors would rely on the special guarantee system and would not concern themselves with the use made of the borrowed funds, analogous to the attitude of purchasers of German government-guaranteed bonds. In any case, an IDA default would affect the Bank's credit standing, and so from the Bank's standpoint it would perhaps be better to have IDA borrow. However, account should be taken of the fact that IDA is regarded as a "charitable" organization and that its bonds, even with a government guarantee, would be rated below the Bank's. IDA would very likely have to pay 1/2 - 3/4\% more than the Bank.

B. Dresdner Bank

G. Gluck, General Manager
R. Stossel (Economic Department)
- Richebaecher.

The premise of the proposal, that it is politically difficult to obtain budgetary appropriations, is not valid for Germany. Putting the proposal into effect might be more costly for governments than the present situation, if the implications of the guarantees are taken together with contributions to the interest equalization fund. The assumption that an adequate volume of funds could be raised if borrowings were confined to balance of payments surplus countries is questionable, since there is no necessary coincidence between a surplus in the balance of payments and a surplus of loan capital.

The amount which could be raised in Germany is limited and might very much depend on when the borrowing took place. The largest single foreign issue, with the exception of Bank borrowings, has been $50 million. The most the Bank could raise in any year is likely to be $100 million. Bank borrowing for IDA would be at the expense of funds for its own operations. It is possible that by offering a slightly higher rate a bit more could be raised but it would be undesirable for a single institution to borrow at two different rates at the same time. Bank borrowing in IDA's behalf would have the advantage of leaving
the matter of guarantees to the Bank and governments, without involving the investor. Moreover, as IDA is known to give credits on conditions which are easier than those associated with conventional lending, it is likely to be more difficult to sell IDA bonds even with government guarantees.

Multiple (collective) government guarantees are in any event not appealing to the German investor. An IDA bond guaranteed by the German government alone could probably be offered on Bank interest terms; a bond guaranteed as contemplated by the proposal would require 1/2 - 1% higher interest - which would probably make it necessary for the Bank to raise its own rate thereafter. If the German government were willing to guarantee fully IDA bonds sold in Germany, this would not only keep down the interest rate but might even enable IDA to raise up to $100 million for itself, on top of the borrowings by the Bank for its own needs. This would not be possible with a multiple guarantee. Perhaps, if IDA were to be the borrower, its first issue might be guaranteed by the German government, with a subsequent shift to a collective government guarantee after IDA is better known.

The Bank's image in Germany would not be adversely affected by Bank borrowing in IDA's behalf, nor should it become harder to sell participations. There are not so many shadings of market ratings in Germany as in the United States, for example, and some industrial issues are rated as highly as government bonds. However, if IDA defaulted on a Bank loan, that would hurt the Bank; the situation of a country defaulting on an IDA credit, as distinguished from a borrower defaulting to a private bank, could not be kept secret. For this reason, and to avoid any possibility of injury to the Bank's standing, it might perhaps after all be better for IDA to be the borrower.

C. Deutsche Bank

Dr. Krebs
Kurt Stahl, Director
Ulf Siebel

In the absence of some provision for compulsory investment in Bank/IDA bonds, no more than $75 million a year can be raised in Germany for the Bank and IDA together. After several annual issues a problem of portfolio diversification would arise: German investors would have to be willing to hold more Bank/IDA bonds than any other kind of foreign issues and it is problematical whether they would be willing to do so. Perhaps the Bank could raise a bit more by offering a higher rate for funds borrowed for IDA, but it is inadvisable for an institution to borrow at different rates in any one market at the same time. It is doubtful that the Bank could meet its own needs as well as the needs of IDA. In addition to Germany's $75 million, France might provide $30 million, Switzerland, the Netherlands, the U.K. and Italy might provide $15 million each, and Austria and Sweden $5 million each, for a total of some $175 million from Europe. Adding this to an estimated $300 million from the U.S. market would give a global aggregate of some $475 million for the Bank and IDA together.

The suggestion that the elimination of budgetary items for IDA should mean more funds available through the market is not persuasive. It is doubtful that governments would be willing to agree to restrict their own approach to the markets, in addition to undertaking the other obligations contemplated by the proposal.
The guarantee aspect of the proposal can be expected to meet resistance, since European governments already have extensive guarantee commitments, as well as cash obligations for development aid. But assuming governments were willing to give guarantees, the market would look first to the debtor and then to the guarantees: the quality of the debtor can not be improved by a guarantee system. A collective guarantee system would be desirable; a system of national guarantees would tend to make for differences in the quality of issues, depending on the standing of the guarantor. If the Bank approached the market, the guarantee system would then be a matter between the Bank and IDA, not involving investors. Germany might perhaps borrow in its own market and lend directly to the less developed countries, without going through IDA; Germany derives greater political benefit from bilateral aid.

Since funds would be borrowed for 15-20 years and put out for 30 years, perhaps longer, refinancing would be necessary and is contemplated by the proposal. However, it is at least possible that when funds are needed to retire obligations, markets may not be able to provide the requisite amounts. Presumably then governments, under their guarantees, would have to find the funds to retire outstanding borrowings. If IDA should default on a Bank loan made out of borrowed funds, governments again would be called upon and some might well have difficulty in finding the necessary amounts at short notice. There might also be foreign exchange difficulties at the time repayment is due to bondholders. In the last analysis, governments would have to step in whenever there was a lack of, or insufficient, liquidity in the market or if there were balance of payments difficulties. Bankers and prospective investors are bound to take note of this possibility.

The Bank cannot now expect to borrow in Germany at 5%, the rate carried by the first Bank loan in Germany and, as noted above, an annual borrowing program would be difficult to execute. It is unlikely that an issue as large as $75 million in deutsche marks could be sold even at 5½%, unless some 30-40% were taken up by investors outside Germany; the local demand for 5½% bonds will not absorb an issue of that size. (At present, a withholding tax on domestic D-mark issues held by foreigners gives temporary support to foreign issues denominated in D-marks, even if carrying lower interest, but this situation may be expected to change).

Borrowing for IDA would impair the Bank’s ability to raise funds: larger amounts would be floated in the German market and the Bank would have to offer a higher rate to induce investors to hold more, or to tap a new group of investors. On the other hand, Bank borrowing for IDA would not adversely affect the Bank’s market standing, unless the magnitude of such borrowings is very large and loans to IDA come to represent a high proportion of the Bank’s portfolio. In that event, even the intermediary of government guarantees would not preclude adverse consequences for the Bank. A default by IDA on a Bank loan would have an adverse effect on the Bank if the default became known and the amount were substantial.

Two views were expressed concerning the rate at which IDA could borrow. Dr. Krebs thought IDA should be able to borrow at the Bank rate. His colleagues
were more doubtful, on the ground that IDA is not likely to be considered as good a debtor. Insurance companies could not invest in IDA bonds unless and until the bonds qualified for such investment; even in the latter event, insurance companies might hesitate, having in mind that IDA would, under the proposal, henceforth have no capital of its own and that it was likely to be necessary to call on governments under the guarantees. At the same time, two institutions can ordinarily borrow somewhat more than one, an argument for having IDA approach the market in its own name, rather than through the Bank.

V. UNITED KINGDOM

A. Bank of England

Mr. Hollom, Chief Cashier
Mr. Portsmore
Mr. Edgeley

The basic question is how the market would be permitted to react. The amounts contemplated are very large and the feasibility of the United Kingdom making a sizeable contribution would have to be evaluated in the light of the balance of payments situation at the time of borrowing. The United Kingdom is now in a deficit situation and is incurring debt; the deficit would have to be righted and the debt repaid and granting that the Horowitz proposal is for the future, these two activities are likely to be still engaging the U.K. government in 1966 or 1967.

It is difficult to envisage circumstances in which anything like the amounts contemplated by the proposal could be raised globally, unless governments determine that those amounts should be raised and take steps to assure that the goal can be reached. This is a very big assumption. But assuming governments do take that decision, then on a reasonable division between the United States and Europe and a reasonable allocation among the European markets, the target should be possible.

Mr. Hollom is not personally much drawn to any proposal starting from the proposition that a guarantee is not costly for the guarantor. A guarantee is often very costly. The market can be expected to demand a joint and several guarantee. Several guarantees would be difficult to sell and would mean a higher cost of borrowing and more limited possibilities for raising funds.

At the outset, borrowing for IDA should not infringe on the Bank's ability to meet its own needs, assuming no governmental ceiling on permissible borrowing. The difficulty would appear as the scheme is carried on year after year. At the same time, within any single year it would be better to float two issues of, say, £25 million each, than a single issue of £50 million. The market mechanism could handle the amounts proposed, but it did not make it easier to borrow to announce in advance a large program to be carried out over a long period; the market would take note of the burden proposed to be put upon it.

The Bank's borrowing cost is likely to be above, but only slightly above, the British government's cost of borrowing. The security behind the
bonds would be comparable to, if not better than, that behind British government issues, but the bonds would have a more limited saleability, partly because of the size of the issues contemplated and partly because investors would be unfamiliar with them. The Bank is known in the United Kingdom but it has had few issues and there has been little turnover in its bonds. If IDA were the borrower, it would have to pay about \(1/4\%\) over British government bonds, at least at the outset; perhaps this could be slightly shaded later.

IDA issues would be competitive with those of the Bank in investment portfolios. However, the limit which investors might set on the amounts of each they would be willing to hold would not necessarily be low. At the same time, it is not possible to say how the market would react to the bonds of an institution which does not look to earning a return on its credits but in effect gives money away. Very likely this potential difficulty can be overcome in the presentation to the market, but it will have to be considered. The holdings of United Kingdom insurance companies are not regulated; these companies are not governed by the "trustee list". Bank bonds are on that list and presumably IDA bonds would be, as well.

Bank borrowing for IDA should not adversely affect the Bank's costs or its reputation, provided the magnitudes are not too large; nor should such borrowing impair the Bank's ability to sell participations. A default by IDA would not hurt the Bank.

Taking the long view, the potential for raising funds under the proposal may be enhanced if IDA approaches the market independently. There are disadvantages to coming often for large amounts. Any possible threat of injury to the Bank's standing should the Bank borrow for IDA could be avoided or minimized by direct IDA borrowing. However, the most simple and efficient course would be to have the government itself borrow in its own market. This would also help to keep down the cost of borrowing.

E. U. K. Treasury

W. W. Morton, Third Secretary
Mrs. Hedley-Miller, Asst. Secretary
Mr. Milner-Barry
[Mr. Portsmore, of the Bank of England]

The government favors an expansion of aid and is willing to consider suggested techniques to this end on their merits. Current circumstances, however, are not favorable to the approach of the proposal.

$60 million annually from the United Kingdom capital market would be a very sizeable addition to amounts already going across the exchanges, particularly year after year, as contemplated by the proposal. The less developed countries would be running a risk that, the budgetary tap having been turned off under the hypothesis of the proposal, capital markets would not be able to produce enough.

Bank borrowing for IDA would not of itself mean a rise in the Bank's cost of borrowing, nor would there be any adverse consequences for the Bank's credit standing or ability to sell participations. Investors will not look past the Bank to the disposition of the borrowed funds. Nor would a default
by IDA hurt the Bank. It is possible that, if the Bank should have to offer a higher rate for the funds destined for IDA, in order to raise funds for IDA's needs over and above its own, this might lure investors away from the Bank's bonds proper, effectively raising the future cost of Bank borrowing.

IDA itself may be regarded as a less attractive borrower than the Bank, being less well-known; the chances are that it would have to pay more, as a direct borrower, than the Bank. Too high a rate might perhaps be self-defeating, causing investors to conclude that the investment must be highly risky.

C. Baring

Andrew Carnwath
Nicholas Baring

Supposing that the government were to give the Bank/IDA unlimited authority to borrow, the market possibilities for securities of international institutions are nevertheless limited. U.K. investors have many outlets for long-term fixed interest funds. They are familiar with British government issues and industrial debentures as the two principal categories; Bank bonds do not fall readily into either category. Although the Bank has borrowed in the U.K. market, its three issues were limited in amount and sporadic; moreover, there has been little trading in its bonds. As an estimate, £30 million a year for the Bank/IDA from the U.K. seems the maximum, and this is on the assumption that the amount would be floated in at least two tranches, and that the bonds would be denominated in sterling; British investors could not take up much of a dollar issue.

A system under which the U.K. government guaranteed bonds sold in the U.K. would be adequate; joint and several guarantees, if obtainable, would be preferable.

The Bank would now have to pay about 1/4% above the government rate for funds to supply its own needs; it should not be necessary to increase the rate just because funds are to be passed on to IDA. The Bank might, however, have to pay more to raise more. It is difficult to envisage the possibility of doubling the volume of Bank borrowing, as the proposal contemplates, without offering a higher rate. IDA would have to pay perhaps 1/4% over the Bank's rate. This might have the effect of spoiling the market for the Bank. Perhaps, since one way or another a higher rate seems indicated if IDA is to rely on the market, it might be better to raise the Bank rate than to introduce IDA as a borrower. Bank borrowing in order to lend to IDA should not injure the Bank's reputation if the guarantee system is satisfactory, nor should the Bank's ability to sell participations be impaired. An IDA default which is not so large as to lead to delay in the honoring of guarantees should have no repercussions for the Bank.

All in all, it would seem better that the Bank be the borrower. This would be less complicated. While there is a possibility that two borrowers might produce slightly more than one, having IDA borrow would amount to introducing a rival institution to raise what in the end would be a relatively limited amount of additional funds.
Borrowing for IDA's needs would be at the expense of the Bank's needs for borrowed funds and would very likely raise the cost of Bank borrowing.

Before it would be possible to place Bank bonds in the large amounts contemplated, it would be necessary to have an active educational campaign. The three Bank issues already floated in the U.K. market have not been actively traded. Investment managers would want some assurance that active trading would be possible. Government bonds are actively traded, but industrial debentures are not, once they are fully paid. Investors would rather take their pick of new issues as they come out, so paid-up industrials go into portfolios and remain there. Bank bonds fall neither into the government nor the industrial category, and their saleability would be directly related to the volume of market activity thought to be feasible for that kind of security. The capital market route is risky for the less developed countries insofar as concerns an assured and regular flow of funds.

A system of "several" guarantees would reduce the marketability of the bonds; investors had unhappy experiences with such guarantees in the '30s. Joint and several guarantees are far preferable, though these might be difficult to obtain from the smaller countries.

The cost to the Bank would probably be about 1/4% above the government's cost of borrowing, assuming bonds denominated in sterling. (There is the possibility of Eurodollar borrowings, in which event the rate would probably be 1/4% above the N.Y. market rate, but the scope of the market for Eurodollar borrowings is not really known). That cost would in principle hold whether the Bank borrows for itself or for IDA, but the rate would probably have to rise with the magnitude of borrowings and a gradual awareness that funds were going to IDA. If IDA goes to the market itself, it would probably have to pay 1/4% more than the Bank.

A gradual erosion of the Bank's credit standing could be expected if it continued to borrow for IDA. There would be a more critical press. It would gradually become harder for the Bank to borrow, detrimental to the conduct of its regular activities. Any IDA default could be expected to have an adverse effect on the Bank.

It would be preferable for IDA to borrow directly, keeping the Bank and IDA activities separate. It would be easier to explain an IDA borrowing, and a separate market approach would help to keep the Bank's standing unimpaired. It might also have the consequence of producing a bit more from the market, since two borrowers might be able to raise more than one.
THE HOROWITZ PROPOSAL

The attached draft of a staff report on the above subject, prepared in response to a resolution of the United Nations Conference on Trade and Development, is circulated for discussion at the meeting on Wednesday, December 16, with a view to subsequent circulation to the Executive Directors and, thereafter, submission to the Secretary-General of the United Nations.

It would help to expedite any necessary revision of the draft if comments could be given to Mr. Demuth or Mrs. Boskey before the meeting.

C. H. Davies
Secretary

Distribution:
President
Vice Presidents (Bank and IFC)
Economic Adviser to the President
Special Advisers to the President
Department Heads
Special Representative for UN Organizations
Mr. de Wilde
Personal Assistant to the President

Copies for information:
Department Heads (IFC)
Assistant Department Heads
December 2, 1964

Governor David Horowitz
Bank of Israel
Jerusalem, Israel

Dear Governor Horowitz:

At the request of Mr. Woods, who is on a short overseas trip, I am pleased to send you for comment the present draft of the Bank staff study on your proposal for raising funds for IDA through the capital markets of the world. The draft is being distributed today to the Bank's Department Heads for review and Mr. Woods wanted you to have the document at the same time.

After such revision of the document as may be necessary to take account of comments made by you and by the Department Heads, we intend to distribute the report to the Bank's Executive Directors, hopefully during the second half of this month. As I think you are aware, while the Executive Directors will be asked to authorize submission of the report to the United Nations, they will not be asked to approve it; as stated in the draft, the document is a staff report and does not purport to represent the views of either the Executive Directors or of the Bank's member governments.

Mr. Woods has told the Secretary General of the United Nations that we expect to submit the report to the United Nations by the end of the year. We may miss this target date by a bit, but we are anxious not to delay submission any longer than absolutely necessary. I would hope, therefore, that it would be possible for you to let us have your comments within a matter of two or three weeks at the latest. If you believe that it would be helpful to give us those comments in person, we would be happy to have you visit the Bank again, at our expense, for this purpose. Or, alternatively, if you believe it essential, we would
Dear [Name],

I am writing to express my sincere apologies for the delayed reply to your recent email. I have been quite busy with a number of other commitments, which has caused a delay in my response.

I understand the importance of the matter you have brought to my attention. I assure you that I will do everything in my power to resolve the issue as soon as possible. Please rest assured that I value your patience and understanding during this time.

Thank you for your understanding and I look forward to working with you.

Sincerely,

[Your Name]
try to arrange to have a staff member come to Israel to obtain your views.

I would greatly appreciate it if you could let me know as soon as possible when we may expect your comments and what procedure you wish to follow to convey them to us.

With kind personal regards,

Sincerely yours,

Richard H. Dasmuth
Director
Development Services Department

Enc.

RHD:tf

cc: Mr. Woods
OFFICE MEMORANDUM

TO: Mr. Richard H. Demuth
FROM: Dragoslav Avramovic
SUBJECT: The Horowitz Proposal

DATE: December 1, 1964

1. I have several major comments on the Second Draft and a number of specific suggestions.

2. I do not think that a clear distinction has been maintained between technical issues and policy issues. I assume that Part II - Technical Issues Raised by The Proposal - was intended to be restricted to a technical discussion; in fact, it has many value judgments on which opinions are likely to differ. Furthermore, most of these value judgments are drafted in a manner which throws doubts on the proposal, although the purpose of the technical discussion was presumably to define the technical issues rather than to pass a value judgment on them. Several examples will show what I have in mind:

(a) The very beginning of the discussion of the technical issues states flatly that they are difficult, even though they have not yet been discussed (p. 10, last para.).

(b) The section on the access to markets ends with a statement raising the question of the political feasibility of assuring access to markets (p. 18, first para.).

(c) The section on balance of payments considerations ends with a statement implying that these considerations would restrain the governments from permitting borrowings for IDA (p. 21, first para.).

(d) The section on the Interest Equalization Fund explicitly states, in the introduction, that creation of the proposed interest equalization fund raises no particularly difficult technical problems, although, because it involves an express or implied commitment to appropriate funds for a long period of years, it may pose a difficult political issue for some countries (p. 31, second para.).

3. I am convinced that the report would gain both in clarity and in impartiality of treatment if it systematically separated the technical discussion from the policy discussion. Furthermore, the purpose of both discussions, in my view, should be to indicate what conditions must be met for the proposal to work; I should think that it is up to the governments, and not up to us, to judge whether these conditions are difficult to meet, and if they are difficult, how difficult they are.
4. There is one major inconsistency in the report. In the section on the borrowing prospects in the markets concerned, the position is taken that these prospects are gloomy almost irrespective of the interest rate that is offered. In the section on interest rate considerations, the view is taken that the willingness of financial markets to buy securities depends on the yield offered, since money is normally available at some price.

5. There is a way out. The problem is that at any one time, financial markets will probably say that the room for any new security is very narrow: they operate with a given supply of known securities and they are naturally cautious in giving any forecasts of how much could be mobilized by issuing a new security. In fact, of course, the supply creates its own demand; and a new security, with a satisfactory yield and proper guarantees, may over time command a much larger market than the initial estimates would have it.

6. The difficulty with the section on the borrowing prospects is that it may not have put the proposed operation into a proper perspective. Such a perspective is not given by quoting how much the Bank has borrowed in the past and how much it will borrow in the future; what is needed is to relate the proposed issue to the aggregate of long-term issues, both domestic and foreign, to changes in this aggregate over time and to the likely growth of the capital markets in the future. The proponents of the proposal will say that by restricting the perspective we have artificially narrowed down the frame of reference; and that however correct our estimate may be for the initial phase of the operation, we have failed to indicate its potential for the future.

7. The section on the balance of payments considerations contains a number of comments indicating the difficulties surrounding the proposal. However, it has omitted to underline the fundamental positive feature which the proposal has: if applied, it would correct at least in part, the present anomaly in which the balance of payments position is not taken into account, or is taken into account only indirectly, in international burden sharing.

8. At the last meeting of the Ad Hoc Committee, the majority felt that the report is cast in an excessively negative tone. While the redraft contains a number of changes, it seems to me that the impression which is left remains negative and polemical.

Some Specific Suggestions

9. Introduction - Delete last paragraph on page 2 ("This study analyzes..."), it is unnecessary. Delete last sentence in the first paragraph on page 4 ("Work is in progress..."), it may delay the consideration of the proposal.
10. The Proposal - Redraft the paragraph on page 9 to avoid the conceptual difficulty raised by "relative economic strength". Many will argue that the present system of international burden sharing does not take sufficiently into account the relative economic strength; and at least some will argue that the resort to the capital market will in effect solve the dilemma posed by the difference between the savings and the transfer aspects of burden-sharing which is now insufficiently taken into account. Also, redraft is needed to indicate that the problem of adjustment of IDA operations to the amount of funds raised could be resolved by having a subsidiary scheme of a program of borrowing in various markets over a number of years.


12. Borrowing Prospects in the Markets Concerned - See comments under 4-6 above.

13. Access to Markets - The two full paragraphs on page 17 repeat what has been said earlier and can be compressed into a couple of sentences. We should simply state that effective arrangements regarding access are needed in order to assure continuity of funds. The arguments adduced in the first paragraph on page 17 in effect say that such arrangements would be against Part I countries' interests; it is difficult to see how these arguments lead to the conclusion of the section.

14. Balance of Payments Considerations - See comment under paragraph 7 above. Also, delete the last sentence in the first paragraph on page 19 ("Moreover, it could be expected...").

15. Government Guarantees - Redraft the statement on Bank lending in second paragraph of page 24 (end of page): the Bank has been lending to IDA countries! Further, it is questionable whether page 29 is needed since the possibility that is discussed is discarded.

16. Policy Issues - Add under (a) on page 39 the fundamental advantage of the proposal: the possibility of expanding IDA operations at a much lower initial cost than in the case of capital subscriptions.

cc: Mrs. Boskey
OFFICE MEMORANDUM

TO: Mr. Richard H. Demuth  
FROM: Dragoslav Avramovic  
DATE: November 30, 1964

SUBJECT: The Horowitz Proposal

1. I have several major comments on the Second Draft and a number of specific suggestions.

2. I do not think that a clear distinction has been maintained between technical issues and policy issues. I assume that Part II - Technical Issues Raised by The Proposal - was intended to be restricted to a technical discussion; in fact, it is full of value judgments on which opinions are likely to differ. Furthermore, most of these value judgments are drafted in a manner which throws doubts on the proposal, although the purpose of the technical discussion was presumably to define the technical issues rather than to pass a value judgment on them. Several examples will show what I have in mind:

(a) The very beginning of the discussion of the technical issues states flatly that they are difficult, even though they have not yet been discussed (p. 10, last para.).

(b) The section on the access to markets ends with a statement raising the question of the political feasibility of assuring access to markets (p. 16, first para.).

(c) The section on balance of payments considerations ends with a statement implying that these considerations would restrain the governments from permitting borrowings for IDA (p. 21, first para.).

(d) The section on the Interest Equalization Fund explicitly states, in the introduction, that creation of the proposed interest equalization fund raises no particularly difficult technical problems, although, because it involves an express or implied commitment to appropriate funds for a long period of years, it may pose a difficult political issue for some countries (p. 31, second para.).

3. I am convinced that the report would gain very much both in clarity and in impartiality of treatment if it systematically separated the technical discussion from the policy discussion. Furthermore, the purpose of both discussions, in my view, should be to indicate what conditions must be met for the proposal to work; it is up to the governments, and not up to us, to judge whether these conditions are difficult to meet, and if they are difficult, how difficult they are.
1. There is one major inconsistency in the report. In the section on the borrowing prospects in the markets concerned, the position is taken that these prospects are gloomy almost irrespective of the interest rate that is offered. In the section on interest rate considerations, the view is taken that the willingness of financial markets to buy securities depends on the yield offered, since money is normally available at some price.

5. There is a way out, but it has not been exploited. The problem is that at any one time, financial markets will probably say that the room for any new security is very narrow: they operate with a given supply of known securities and they are naturally cautious in giving any forecasts of how much could be mobilized by issuing a new security. In fact, of course, the supply creates its own demand: and a new security, with a satisfactory yield and proper guarantees, may over time command a much larger market than the initial estimates would have it.

6. The fundamental difficulty with the section on the borrowing prospects is that it does not put the proposed operation into a proper perspective. Such a perspective is not given by quoting how much the Bank has borrowed in the past and how much it will borrow in the future; what is needed is to relate the proposed issue to the aggregate of long-term issues, both domestic and foreign, to changes in this aggregate over time and to the likely growth of the capital markets in the future. The proponents of the proposal will say that by restricting the perspective we have artificially narrowed down the frame of reference; and that however correct our estimate may be for the initial phase of the operation, we have failed to indicate its potential for the future.

7. The section on the balance of payments considerations contains a number of comments indicating the difficulties surrounding the proposal. However, it has omitted to underline the fundamental positive feature which the proposal has: if applied, it would correct at least in part, the present anomaly in which the balance of payments position is not taken into account, or is taken into account only indirectly, in international burden sharing.

8. At the last meeting of the Ad Hoc Committee, the majority felt that the report is cast in an excessively negative tone. While the redraft contains a number of changes, the impression which is left remains negative and polemical.

Some Specific Suggestions

9. Introduction - Delete last para. on page 2 ("This study analyzes..."); it is unnecessary. Delete last sentence in the first para. on page 1 ("Work is in progress..."); it may delay the consideration of the proposal.
10. The Proposal - Redraft the para. on page 9 to avoid the conceptual difficulty raised by "relative economic strength". Many will argue that the present system of international burden sharing does not take sufficiently into account the relative economic strength; and at least some will argue that the resort to the capital market will in effect solve the dilemma posed by the difference between the savings and the transfer aspects of burden-sharing which is now insufficiently taken into account. Also, redraft is needed to indicate that the problem of adjustment of IDA operations to the amount of funds raised could be resolved by having a subsidiary scheme of a program of borrowing in various markets over a number of years.


12. Borrowing Prospects in the Markets Concerned - See comments under 4-6 above.

13. Access to Markets - The two full paragraphs on p. 17 repeat what has been said earlier and can be compressed into a couple of sentences. We should simply state that effective arrangements regarding access are needed in order to assure continuity of funds. The arguments adduced in the first para. on p. 17 in effect say that such arrangements would be against Part I countries' interests; it is difficult to see how these arguments lead to the conclusion of the section.

14. Balance of Payments Considerations - See comment under para. 7 above. Also, delete the last sentence in the first para. on page 19 ("Moreover, it could be expected...").

15. Government Guarantees - Redraft the statement on Bank lending in second para. of page 24 (end of page): the Bank has been lending to IDA countries! Further, it is questionable whether p. 29 is needed since the possibility that is discussed is discarded.

16. Policy Issues - Add under (a) on p. 39 the fundamental advantage of the proposal: the possibility of expanding IDA operations at a much lower initial cost than in the case of capital subscriptions.
Mr. Alexander Stevenson

November 19, 1964

O. J. McDiarmid

Horowitz Proposal

I have read the second draft (November 4, 1964) of the Staff Report on the Horowitz Proposal and have a few points to add to my memorandum of October 9 to you on this subject.

This draft, as the previous one, reaches no conclusion regarding the overall merits of the proposal and therefore its value is limited. I suppose however that the implicit conclusion is that the proposal by itself cannot be considered as a solution to IDA's replenishment (or expansion) problem. The "related approaches" mentioned in page 38 are perhaps suggested as substitutes for the original. If they are to be considered as recommendations of the Bank, I should think they would need more justification than is given in this draft. Particularly the proposal that IDA borrow from governments (page 39) needs much fuller consideration before it is recommended by the Bank. The chances of governments being repaid for these loans would seem remote unless IDA's operations were being wound up or at least substantially curtailed. Also there might be some unfavorable reaction to a minor league Horowitz program (with all its associated problems) on top of regular IDA replenishment.

I have a few secondary points:

1. On page 3, it is said that the U.K. Sweden proposal on "supplementary financial measures", i.e. compensatory financing of balance of payments deficits, should be considered along with the Horowitz proposal. I don't see the connection except (God forbid) IDA should undertake both.

2. On page 21, the part in parentheses suggests that some of the funds borrowed for IDA might be tied "after international bidding". This might make it difficult to secure multilateral guarantees. Would a country be prepared to guarantee borrowings in another market if purchases were tied to the market in which the funds were raised?

3. On this question of guarantee (page 27) I take it that "limited joint and several guarantees" means that if the U.S. market absorbs half the bonds, the U.S. stands good half the losses, if any. This, of course, would give less than full assurance to the U.S. bond holders since, if there is any reneging by other members, some uncovered losses would still be possible. This would mean a higher interest rate.
4. On page 30, the paper recommends that IDA and not the Bank be the borrower. Besides the legal problem of qualifying IDA as a borrower, I should think the psychological and perhaps irrational response of the market to IDA's borrowings would be very unfavorable because of the terms of its lending operations. I suspect that the prospective bond holders would want to have a guarantee two or three times the amount of bond sales.

5. I don't understand why the projection on page 33 is limited to disbursements over only five years. It would be interesting to see how the interest deficit would build up and eventually peak out over a long period.
<table>
<thead>
<tr>
<th>NAME</th>
<th>ROOM NO.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Messrs. Wilson</td>
<td>1220</td>
</tr>
<tr>
<td>Knapp</td>
<td>1220</td>
</tr>
<tr>
<td>Aldewereld</td>
<td>340</td>
</tr>
</tbody>
</table>

To Handle | Note and File
---|---
Appropriate Disposition | Note and Return
Approval | Prepare Reply
Comment | Per Our Conversation
Full Report | Recommendation
Information | Signature
Initial | Send On

REMARKS

I would welcome any comments.

From Richard H. Demuth
Attached is a draft of the staff report on the Horowitz Proposal. An earlier version was reviewed by the Ad Hoc Committee on the Horowitz Proposal (composed of Messrs. Adler, Avramovic, Broches, Cavanaugh, Cope, Friedman, Gordon, Rist and Stevenson) and the present draft has been prepared in the light of the Committee's comments. Members of the Committee are being asked to review the new version and to give me any further comments which they may have. I am also sending copies to Messrs. Wilson, Knapp and Aldewereld for information and any comments they may wish to make. I would expect to revise the draft in the light of comments received and then to submit it for consideration by the Senior Staff Meeting towards the end of the month; by that time we shall be in a position to incorporate in the report a paragraph on the views of the European financial communities, based on the inquiries which Mr. Friedman and Mrs. Boskey will be making in the next 10 days.

After you have had a chance to read the document, I should appreciate your views as to whether we are taking generally the right line. I should also like to discuss with you when we should send the draft to Governor Horowitz. You will recall that he asked me, and repeated the request to you at luncheon, for an opportunity to see the report before it took its final form, and that it was agreed that he should have that chance.
DATE OF WIRE: NOVEMBER 7, 1964  0943

LOG NO.: WU 5

TO: INTBAFRAD

FROM: BASEL

TEXT:

ARRIVED BASEL

BOSKEY FRIEDMAN

FAMILY NOTIFICATIONS HAVE BEEN MADE
OUTGOING WIRE

TO: INTBAFRAD
    DE LESSEPS
    PARIS

DATE: November 3, 1964

CLASS OF SERVICE: NLT

COUNTRY: FRANCE

TEXT: FRIEDMAN BOSKEY HAVE TICKETS COVERING WHOLE TRIP INCLUDING EUROPEAN TRAVEL

AND RESERVATIONS TO AND FROM EUROPE STOP INTEREUROPEAN RESERVATIONS FOR 

ITINERARY YOU ARE WORKING OUT TO BE MADE YOUR END 

BOSKEY

NOT TO BE TRANSMITTED

MESSAGE AUTHORIZED BY:

NAME Shirley E. Boskey

DEPT. Development Services Department

SIGNATURE (Signature of Individual Authorized to Approve)

CLEARANCES AND COPY DISTRIBUTION:

cc: Mr. Friedman

ORIGINAL (File Copy)

(IMPORTANT: See guide for preparing form)
OUTGOING WIRE

DATE: November 3, 1964

TO: INTERPOL
De Jussieu
PARIS

COUNTRY: FRANCE

TEXT:

IMPERMANENT ROSENTHAL HAVE TICKETS COVERS WHOLE TRIP INCLUDING EUROPEAN TRAVEL AND RESERVATIONS TO AND FROM EUROPE STOP INTERNATIONAL RESERVATIONS FOR ITINERARY YOU ARE WORKING OUT TO BE MADE YOUR END ROSEK

NOT TO BE TRANSMITTED

MESSAGE AUTHORIZED BY:

NAME: Spliant & Rejes

DEPT.: Development Services Department

COMMUNICATIONS

FILE COPY (for use by Archives Division)

IMPORTANT: See guide for preparing form)
TO: FERRAS
    BIS
    BASLE

DATE: November 2, 1964

COUNTRY: SWITZERLAND

CLASS OF SERVICE: LT

TEXT: Thank you. Glad to accept.

Friedman

NOT TO BE TRANSMITTED

MESSAGE AUTHORIZED BY: Irving S. Friedman

NAME

DEPT.

Office of the President

SIGNATURE

(SIGNATURE OF INDIVIDUAL AUTHORIZED TO APPROVE)

CLEARANCES AND COPY DISTRIBUTION:

For Use by Archives Division

ORIGINAL (File Copy)

(IMPORTANT: See Secretaries Guide for preparing form)

Checked for Dispatch:
TO: INTRAFAQ LESSEPS

DATE: October 30, 1964

CLASS OF SERVICE: FULL RATE

COUNTRY: PARIS

TEXT: RUR 534 OUR ROUND TRIP RESERVATIONS ALREADY MADE THANKS

Cable No.: BOSKEY

NOT TO BE TRANSMITTED

MESSAGE AUTHORIZED BY:

NAME: Shirley Boskey

DEPT.: Development Services Department

SIGNATURE: [Signature]

CLEARANCES AND COPY DISTRIBUTION:

cc: Mr. Friedman

For Use by Archives Division

ORIGINAL (File Copy)

(IMPORTANT: See guide for preparing form)

Checked for Dispatch:
DATE OF WIRE: OCTOBER 30, 1964

LOG NO.: RC 20

TO: INTBAFRAD BOSKEY

FROM: PARIS

TEXT:

534

IN ORDER ENABLE US RESERVE SEATS FLIGHTS EUROPE PLEASE ADVISE IF YOURSELF FRIEDMAN HAVE ROUND TRIP AIR TICKETS THANKS

LESSEPS
Mr. Richard H. Demuth  
Director  
Development Services Department  
International Bank for Reconstruction and Development  
1818 H Street, N. W.  
Washington, D. C. 20433  

Dear Dick:

Thank you for your letter of October 12, 1964, containing a draft of a portion of your report to the United Nations on the "Horowitz Proposal."

We think that the draft substantially accurately reports what we said in our memorandum submitted to you in June. The only point that might possibly be misunderstood is at the top of page 13, where your draft states (with respect to limited joint and several guarantees where indebtedness is restricted to the amount of the U. S. guarantee) that it should cost "no more than 4 1/2%" to borrow $250-300 million. Our memorandum actually said "at a rate near 4 1/2%", which was intended to cover the possibility that it might be slightly higher.

Our only other comment is that your report might make clearer our position to the effect that any financing done by IDA would have a direct effect on financing operations of the World Bank, resulting in a reduction of the supply of funds available for Bank borrowing and an increase in the cost of such funds. We feel this to be an essential fact to keep in mind in appraising the level of funds that could be raised by the two institutions together.

Please let us know if we can be of any further help to you in this matter.

With best regards,

Sincerely yours,

Dudley N. Schoales
October 29, 1964

Mr. Edward Townsend, Senior Vice President  
The First Boston Corporation  
20 Exchange Place  
New York, New York 10005  

Dear Ed:  

After we talked with you yesterday, we revised, in the light of the comments which you and Andy made, the paragraph in the draft report on the Horowitz Proposal intended to reflect our impression of the views of the New York market. We thought your points were well taken and we appreciate your having read the material so carefully.

I enclose the revised text and would be glad to know whether you and Andy consider that we have overcome the difficulties you had with the original language.

I am sending a copy of the revision to Morgan Stanley as well, with a letter explaining that the revision was done after we had talked with you.

Thank you again for your help.

With kind regards,

Sincerely yours,

Richard H. Demuth  
Director  
Development Services Department
These representatives were of the opinion that it would be unrealistic to envisage global borrowings for IDA of $2,000 million a year for 10 years, the order of magnitude of the proposal as presented to UNCTAD. As for the volume of funds which they thought it would be realistic to contemplate raising for IDA, they made several points. First, they commented that it would in fact be highly relevant whether at the time of any borrowing it was government policy to discourage capital outflows in excess of a particular amount. Secondly, they said it was difficult to reach a judgment concerning the possible magnitude of borrowing for IDA without knowing whether other borrowers might be approaching the market at about the same time and what rate such other borrowers might be willing to offer. On the assumptions that at the time of borrowings for IDA (a) foreign borrowings were not subject to restriction (b) no other offerings on generally comparable terms were immediately in prospect and (c) market conditions were comparable to those now prevailing, they expressed the view that it should be possible to sell annually in the U.S. and Canadian markets roughly $200—300 million of bonds offered by or for purposes of IDA, provided these bonds had behind them a system of "limited joint and several guarantees" (the kind of guarantees built into the Bank's capital structure) and carried interest at 5%. If the bonds were offered with an undertaking that outstanding borrowings within the framework of the proposal would never aggregate more than the amount of the U.S. guarantee, they thought $250—300 million might be borrowed at approximately 4½%. If, however, the bonds were supported only by a system of "several" guarantees, they thought that not more than $150—200 million annually could be raised in the U.S. and Canadian markets, even at interest as high as 5½—6½; this was a more tentative conclusion, since there has
been no market experience with a security of that character.

They cautioned, however, that borrowings of any of the indicated orders of magnitude for the benefit of IDA might well make it more costly for the Bank to borrow for its own purposes.

1/ The question whether and to what extent governments would be likely to restrict the rate of interest carried by bonds issued for purposes of the proposal is discussed in a subsequent subsection; the obligations which various types of guarantee would impose on governments are described below at p. et seq.
October 29, 1964

Mr. Dudley Schoales
Morgan Stanley & Co.
2 Wall Street
New York, New York 10005

Dear Dudley:

On October 12 I sent to you and Andy Overby a copy of that part of our draft report on the Horowitz Proposal which is intended to reflect our discussions with you and with First Boston. Yesterday Andy and Ed Townsend called to give me some comments on the draft text. As a result of that conversation, we have revised the paragraph which begins with the words "The representatives expressed the view", at the bottom of page 12. I enclose the language of the revised paragraph and I would appreciate it if in reviewing the material you would substitute this for the original wording. I have also sent the revised paragraph off to First Boston.

With kind regards,

Sincerely yours,

Richard E. Demuth
Director
Development Services Department

SEBoskey/Jk
These representatives were of the opinion that it would be unrealistic
to envisage global borrowings for IDA of $2,000 million a year for 10 years,
the order of magnitude of the proposal as presented to UNCTAD. As for
the volume of funds which they thought it would be realistic to contemplate
raising for IDA, they made several points. First, they commented that it
would in fact be highly relevant whether at the time of any borrowing it
was government policy to discourage capital outflows in excess of a particular
amount. Secondly, they said it was difficult to reach a judgment concerning
the possible magnitude of borrowing for IDA without knowing whether other
borrowers might be approaching the market at about the same time and what
rate such other borrowers might be willing to offer. On the assumptions that
at the time of borrowings for IDA (a) foreign borrowings were not subject to
restriction (b) no other offerings on generally comparable terms were
immediately in prospect and (c) market conditions were comparable to those
now prevailing, they expressed the view that it should be possible to sell
annually in the U.S. and Canadian markets roughly $200-300 million of bonds
offered by or for purposes of IDA, provided these bonds had behind them a
system of "limited joint and several guarantees" (the kind of guarantees
built into the Bank's capital structure) and carried interest at 5%. If
the bonds were offered with an undertaking that outstanding borrowings within
the framework of the proposal would never aggregate more than the amount of
the U.S. guarantee, they thought $250-300 million might be borrowed at
approximately 4\%\%\%. If, however, the bonds were supported only by a system
of "several" guarantees, they thought that not more than $150-200 million
annually could be raised in the U.S. and Canadian markets, even at interest
as high as 5\%-6\%; this was a more tentative conclusion, since there has
been no market experience with a security of that character. They cautioned, however, that borrowings of any of the indicated orders of magnitude for the benefit of IDA might well make it more costly for the Bank to borrow for its own purposes.

1/ The question whether and to what extent governments would be likely to restrict the rate of interest carried by bonds issued for purposes of the proposal is discussed in a subsequent subsection; the obligations which various types of guarantee would impose on governments are described below at p. et seq.
October 27, 1964

Mr. Robert de Lesseps
4 Avenue d'Iena,
Paris 16e
France

Dear Mr. de Lesseps:

By the time you receive this you will have had a call from Johnnie Miller, enlisting your assistance in making arrangements for the canvass of European financial community views on the market operation aspects of the Horowitz proposal.

I am enclosing 20 copies of a document which we prepared for our discussions with representatives of New York banking houses. We sent it some days in advance of our meetings, to acquaint the recipients with the relevant features of the proposal and to indicate the points on which we hoped to have their comments. We found this effective for the purpose of focussing the discussion and obtaining some reasoned opinions, and believe it would be helpful to send copies of the document to those persons with whom we shall be meeting in Europe. I thought it would save time, since time is getting short, if these were sent on to you so that you could send them off promptly after the appointments are arranged.

I look forward to seeing you in Basel.

Sincerely yours,

Shirley Boskey
Development Services Department

Encs:--
20 copies.

cc: Mr. Friedman

SEBoskey/Jk
MARKET CONSIDERATIONS RAISED

BY THE HOROWITZ PROPOSAL

The International Bank has been asked by the United Nations Conference on Trade and Development (UNCTAD), meeting in Geneva, to study and report to the United Nations on a "Development Financing Plan" submitted to UNCTAD by the Delegation of Israel, led by Mr. D. Horowitz, Governor of the Bank of Israel. The plan, referred to in this memorandum as the "Horowitz Proposal" and described in some detail below, has as an essential element the raising of funds in the private capital markets of the developed countries. The Bank therefore considers it desirable and important that its analysis of the proposal and its report to the United Nations take account of and record the reaction of representatives of the financial markets of the United States, the United Kingdom and Europe to the proposal, with particular reference to the borrowing feature.

This memorandum has been prepared to serve as a basis for exploratory and informal discussions between Bank officials and representative leaders of the financial community in several capital-exporting countries. Following a brief description of the principal elements of the proposal, the memorandum sets forth certain questions relating to the proposal. These questions have been framed, not for the purpose of eliciting categoric replies, but rather to invite and provoke consideration primarily of (a) the feasibility of the approach contemplated, insofar as the market aspects are concerned; and (b) the implications for the Bank/IDA should either become associated with the proposal.

The Proposal

Two basic premises underlie the proposal: first, that a satisfactory rate of economic progress for the developing countries depends upon capital inflows in amounts much larger than have heretofore been available and on terms appropriate to the recipient countries' repayment capacity; and second, that it is not politically realistic to expect development assistance on the scale and terms required to be made available through direct budgetary allocations.

To avoid the necessity of relying primarily on budgetary appropriations for the large amounts of development capital postulated to be required, the proposal contemplates that the funds be obtained from the private capital markets of the developed countries. The technique would be as follows:

(1) The International Bank, the International Development Association (IDA) or some other international institution would borrow funds on commercial terms from private investors. If the borrower is the Bank or some other international institution, and not IDA, the funds borrowed from the private market would be re-lent to IDA on the same terms on which they were raised.
(2) The borrowing in the private market would be made possible by a special system of government guarantees in which all of the industrialized countries which are members of IDA (i.e., the "Part I" countries) would participate, each in a proportion based upon its quota in the International Monetary Fund or upon its subscription to the capital stock of the Bank. The government guarantees would apply directly to the market borrowings or, if the Bank or some other international institution should be the borrower, might alternatively apply to loans by the borrower to IDA of the proceeds of the market borrowings.

(3) In order to reduce balance of payments constraints on the level of multilateral development aid, borrowing operations would be conducted to the extent feasible in those countries which, at the time, had a balance of payments surplus.

(4) The funds raised by the borrowings would be lent by IDA on "soft" terms.

(5) The difference between the market cost of borrowing, on the one hand, and the charges on IDA credits made out of the borrowed funds, on the other, would be met out of an "interest equalization fund" to be created and maintained by the industrialized countries, each country to assume a proportionate share of the annual aggregate, allocated on the same basis as the guarantee liability.

As presented to UNCTAD, the proposal contemplated market operations in the order of $2,000 million a year over a 10-year period. Governor Horowitz subsequently suggested that the target should be lowered, to an aggregate of $3,000 million of borrowings over a period of five years. He envisages that loans out of the borrowed funds would be made for periods up to 30 years, with interest at 1%, and that there might be a 4% differential between this charge and the cost of borrowing, to be met out of the interest equalization fund.

Questions Raised by the Proposal

The Bank is particularly interested in having the views of representatives of the financial community on the following questions:

1. In what circumstances and under what conditions would the markets of the developed countries be able and willing to supply funds as contemplated by the Horowitz proposal?

   (a) What kind of government guarantee would be required? Would a system of "several" guarantees (under which each government would guarantee only a specified proportion of each borrowing or of each loan to IDA) suffice? Would a system of joint and several guarantees (under which each government would be independently liable up to a specified amount) be necessary?
(b) How much is it likely to cost to borrow for purposes of the proposal?

(c) Is the order of magnitude of borrowing contemplated by the proposal realistic in terms of the absorptive capacity of the markets concerned? If not, what order of magnitude would be?

2. The Bank staff estimates that over the next five years, the Bank will require about $1,400 million to meet bond maturities on outstanding borrowings and an estimated $4,000 million to meet disbursements on its loans, a total of some $5,400 million. Some part of this total will be financed through loan repayments, sales of loans, income, etc. But after account is taken of these sources of funds, there will remain some $3,000 million to be raised by borrowing, an average of $600 million a year over the five-year period. Is it reasonable to expect that capital markets of the developed countries could, or would be prepared, to absorb, annually, an average of some $1,200 million of borrowings for the Bank and IDA combined (of which about $900 million would be "new money", i.e., over and above the estimated amount of repayments on outstanding obligations)? Would borrowing for IDA, within the framework of the proposal, be likely to affect the Bank's ability to meet its own need for borrowed funds? Would it be likely to raise the cost of borrowing for future Bank operations?

3. Would Bank participation in the scheme, as borrowing agency, be likely to have an adverse effect upon its credit standing? Would it be likely to affect the Bank's ability to borrow or attract participations?

4. If, by reason of a default on an IDA credit made out of funds borrowed by the Bank, IDA were not in a position to repay a loan from the Bank, would this circumstance be likely to have an adverse effect on the Bank's market standing, even though bondholders were fully protected by the special system of government guarantees?

5. Would there be any advantage or disadvantage from the standpoint of the Bank's future relationship with the market if IDA, rather than the Bank, were to borrow for itself directly?

October 1964.
October 12, 1964

Mr. Dudley Schoales
Morgan Stanley & Co.
2 Wall Street
New York, New York 10005

Dear Dudley:

We have now completed a first draft of the staff report on the "Horowitz Proposal", which was the subject of our meetings with you in June and July. One section of the draft deals with the proposed market operations contemplated by the proposal. It is here that we plan to summarize the views expressed to us by "representatives of the New York financial community", concerning the absorptive capacity of the U.S. and Canadian markets. Although there will be no specific reference to either Morgan Stanley or First Boston, I would like to be sure that what we plan to say fairly reflects your views.

For that purpose, I am enclosing a copy of the five relevant pages of the present draft. You will note that the description of the scale of borrowing contemplated under the proposal differs from that which we sent to you as a point of departure for our discussions. This is because Governor Horowitz, on a visit to the Bank in August, suggested that for purposes of the study the borrowing target should be substantially reduced; an aggregate of $3 billion to be raised over five years, an average of $600 million a year. We have proceeded accordingly.

I should appreciate it if you would let me know whether the material on the last two pages of the enclosure accurately reflects your views or whether you would suggest changes. I am, of course, making the same request of First Boston. We have not yet investigated the European market views but we plan to do so fairly soon.

With kind regards,

Sincerely yours,

Richard H. Demuth
Director
Development Services Department
Dear [Name]

New York, New York 10002

March 12, 1949

Enclosed is a copy of my letter of March 10th to Mr. [Name]. Please review it and let me know if you have any comments or questions.

Sincerely,

[Signature]
PART II

TECHNICAL ISSUES RAISED BY THE PROPOSAL

A. Proposed Market Operations

As noted in Part I, the proposal as it stands at present contemplates that at least $3,000 million would be raised over a five-year period, an average of $600 million a year. These proposed borrowings for IDA would be over and above the amounts required to be borrowed by the Bank in the same markets for its own purposes.

Governor Horowitz has pointed out, in support of the feasibility of borrowings in this magnitude, that fixed-interest obligations in excess of $35,000 million were sold in the markets concerned in 1962. With rising national incomes in the industrialized countries, it should be possible, he argues, to raise an additional $600 million for IDA; if necessary, some of the funds might be provided by diverting to the borrowings for IDA resources which would otherwise be devoted to the purchase of bonds designed to finance investments of lower priority.

There can be no doubt that if governments of the industrialized countries should prove willing (a) to give borrowings for IDA priority in access to their markets, (b) to provide guarantees fully satisfactory to the market, and (c) to permit the borrowings to be made at rates of interest attractive in relation to competing bond issues, the amount of funds envisaged could be raised without difficulty. However, in view of the considerations pointed out below, it cannot simply be assumed that the industrialized countries will agree to allow borrowings for IDA to be made under conditions assuring their success. On the contrary, such borrowings would pose difficult issues for the industrialized countries, which the presentation to UNCTAD may have dismissed too lightly.

For convenience of analysis, the various technical issues raised by

the proposed market operations, although many of them are interrelated, are
discussed separately under the following headings: (1) Absorptive capacity
of the markets concerned; (2) interest rate considerations; (3) balance
of payments considerations; (4) access to markets; (5) government guarantees;
and (6) choice of borrower.

(1) Absorptive capacity of the markets concerned.

In considering the absorptive capacity of the market for borrowings
under the Horowitz plan, it may be of interest to note at the outset the
borrowing record of the Bank itself. The Bank, over its entire history,
has sold bonds in the aggregate amount of $4,200 million in nine different
markets. The largest total of Bank obligations outstanding at any one time
was $2,530 million. The largest amount which the Bank ever borrowed in a
single year (1957-58) is $627 million and the highest five-year average to
date (1956-57 to 1960-61) is $315 million.

Over the next five years, the Bank will, for its own purposes, have
to raise substantial amounts in the market. On the basis of the staff’s
best estimate of the likely volume of lending over this period, the Bank
may need funds in the order of about $4,000 million to meet disbursements
on its loans. During the same period it will also be called upon to meet
about $1,400 million of maturities on its outstanding borrowings. Thus
its total requirements for funds over the next five years are estimated to
be some $5,400 million. Some part of this total will be financed through
loan repayments, sales of loans, income, etc. But after account is taken
of these sources of funds, it is estimated that there will remain some $3,000
million to be raised by borrowing, an average of $600 million a year over
the five-year period, coincidently the figure suggested by Governor Horowitz
as a minimum for borrowings under the proposal. However, since approximately
$1,400 million of this total would be used to retire outstanding obligations and would thus go back to investors, the aggregate of "new money" which capital markets would be called upon to supply for the Bank over the five-year period would be only some $1,600 million, an average of just over $300 million a year.

The question thus arises whether it is reasonable to expect that capital markets in the Part I countries could, or would be prepared, to absorb, annually, an average of some $1,200 million of borrowings for the Bank and IDA combined, of which about $900 million would be "new money". On this issue, it is necessary to look separately at the U.S. and Canadian markets, on the one hand, and the U.K. and European markets, on the other.

Although the United States market is at present highly liquid, the government is attempting, at least temporarily, for balance of payments reasons, to discourage the outflow of capital through foreign issues floated in its markets by the device of an "interest equalization tax" on acquisitions by a United States person of long-term foreign securities (with certain exceptions). The measure was prompted by the fact that within an 18-month period the volume of new foreign issues reaching the U.S. market had more than trebled, rising from an average of less than $600 million a year between 1959-1961 to $1.1 billion in 1962 and to an annual rate of almost $2 billion in the first six months of 1963. The objective of the U.S. Administration, to which the tax and other proposals are directed, is to cut the outflow of capital into new foreign bond and equity issues back toward the range of $500-700 million a year (including new issues of Bank bonds purchased by U.S. residents) that prevailed from 1959 to 1961. It would be reasonable to assume on the


2/ Ibid, p.71. In testimony on the same measure, a year later, before the Committee on Finance of the U.S. Senate, Secretary Dillon noted that experience since the announcement of the proposed interest equalization tax indicated that purchases of foreign issues might be at the rate of "perhaps $600-800 million a year-close to, but still somewhat above, the rate that would have been considered normal prior to 1962". Hearings before the Committee on Finance, U.S. Senate, 88th Cong., 2nd Sess., on H.R.8000 (1964) p.65.
basis of the Bank's experience (and putting to one side any possible application of the proposal's balance of payments criterion) that about one-half of all borrowing for IDA would have to be carried out in the United States. On this assumption, and on the further assumption that the United States Administration continues to pursue its objective of a maximum of some $600 million of foreign issues a year, about one-half of all foreign issues would have to be reserved for IDA if the total envisaged by Governor Horowitz were to be achieved. This would obviously create difficulties for other prospective borrowers in the United States market, including the Bank.

The Bank staff conducted an informal canvass of the view of representatives of the New York financial community concerning the volume of funds which it would be feasible to envisage raising in the United States and Canadian markets, together, on certain assumptions as to the scope of the government guarantees and the rate of interest. Having in mind that the interest equalization tax is a transitional measure, by its terms effective only through 1965, and that the United States hopes, by this and other measures, to bring its balance of payments into equilibrium within a reasonable period, the staff suggested that the judgments concerning the absorptive capacity of these markets be reached without taking account of balance of payments considerations or of the interest equalization tax or other governmental measures designed to discourage capital outflows.

The representatives expressed the view that the magnitude of borrowings contemplated by the proposal as it had been presented at UNCTAD was unrealistic. On the other hand, they were of the opinion that if bonds sold for purposes of the proposal had behind them a system of "joint and several" government guarantees and carried interest at 5%, the U.S. and Canadian markets together should be able to supply roughly $200-300 million annually. If the bonds were offered with an undertaking that outstanding borrowings under the
proposal would never aggregate more than the amount of the U.S. guarantee, they thought it should cost no more than $250-300 million. If, however, governments were prepared to give only "several" guarantees, it was thought that not more than $150-200 million annually could be raised in the U.S. and Canadian markets, even at interest as high as 5½ - 6%; this was a more tentative conclusion, since there has been no market experience with a security of that character.

The situation in the U.K. and European capital markets is somewhat different. Taken all in all, market liquidity has been limited, sometimes principally because available savings have been sufficient only to meet domestic demands or have even been exceeded by these, sometimes because of the lack or inadequacy of machinery to mobilize and channel savings, sometimes both. Whether out of governmental concern to assure that the requirements of domestic borrowers, public and private, are first satisfied, or in an effort to prevent demands of foreign borrowers from driving up domestic interest rates or for other reasons, the absorptive capacity of these capital markets for foreign borrowing is restricted by such factors as explicit controls on new foreign security issues, taxes on new securities, restrictions on the kinds of investments which may be made by institutional investors, etc; some markets have been entirely closed to foreign borrowing. And in addition there is the unintended but nevertheless effective restraint of the institutional shortcomings already referred to. While there is evidence of governmental steps to relax restrictions on foreign borrowings and looking to stronger and more efficient capital market mechanisms, such changes take time to institute and longer to have an impact.

1/ The question whether and to what extent governments would be likely to restrict the rate of interest carried by bonds issued for purposes of the proposal is discussed in the next subsection; the obligations which various types of guarantee would impose on governments are described below at p. 2/

2/ See for a descriptive analysis of the major capital markets in Europe the study entitled "A Description and Analysis of Certain European Capital Markets". Paper No. 3 prepared by the U.S. Department of the Treasury for the Joint Economic Committee of the U.S. Congress, Joint Committee Print, 88th Cong., 2nd Sess. (1964).
There are two other relevant considerations. Some European countries, so far from being able to accommodate a greater external demand for capital, have been stepping up their own borrowing in outside markets, primarily to provide themselves with larger amounts of capital for establishment of new industries, to finance public expenditures and otherwise to support domestic growth. Second, there is already a queue of foreign borrowers for those markets in which borrowing is possible: other governments, developed and less developed, the Bank and other international institutions, and corporate borrowers whose demands are large and habitual. Borrowing for IDA would have to take its place in that queue unless, as a matter of policy, governments were prepared to accord a priority position to such operations.

[Data on European market views to be added]

1/ If available, it might be useful to indicate here or in an appendix recent data on foreign borrowing, in capital markets, by European governments. There is some material in the House Hearings cited above, and in publications of the Federal Reserve Bank of Cleveland. Perhaps it might be possible to suggest, by reference to the amounts floated in European markets (ex-Bank issues) in recent years, what the proposed borrowing for IDA would imply - i.e., what proportion some $300 million a year (Europe's assumed "share" of IDA borrowings) would bear to the recent annual averages of all borrowings (domestic and foreign, public and private) in European markets.
October 12, 1964

Mr. Andrew Overby, Vice Chairman
The First Boston Corporation
20 Exchange Place
New York, New York 10005

Dear Andy:

We have now completed a first draft of the staff report on the Horowitz Proposal, which was the subject of our meetings with you in June and July. One section of the draft deals with the proposed market operations contemplated by the proposal. It is here that we plan to summarise the views expressed to us by "representatives of the New York financial community", concerning the absorptive capacity of the U.S. and Canadian markets. Although there will be no specific reference to either First Boston or Morgan Stanley, I would like to be sure that what we plan to say fairly reflects your views.

For that purpose, I am enclosing a copy of the five relevant pages of the present draft. You will note that the description of the scale of borrowing contemplated under the proposal differs from that which we sent to you as a point of departure for our discussions. This is because Governor Horowitz, on a visit to the Bank in August, suggested that for purposes of the study the borrowing target should be substantially reduced: an aggregate of $3 billion to be raised over five years, an average of $600 million a year. We have proceeded accordingly.

I should appreciate it if you would let me know whether the material on the last two pages of the enclosure accurately reflects your views or whether you would suggest changes. I am, of course, making the same request of Morgan Stanley. We have not yet investigated the European market views but we plan to do so fairly soon.

With kind regards,

Sincerely yours,

Richard M. Deastry
Director
Development Services Department
Dear Mr. Adams,

We have now completed a draft of the annual report on the "Project of the Week," which was the subject of our meeting with the plan. The report highlights the achievements and accomplishments of the project. It is the plan to incorporate these achievements into the "Project of the Plan" document for the next year.

I wanted to extend our gratitude for the interest shown in our project. We would like to be of service further in the future, and we hope you find our work to our benefit.

Yours sincerely,

[Signature]

Director
Department of Development Services
PART II
TECHNICAL ISSUES RAISED BY THE PROPOSAL

A. Proposed Market Operations

As noted in Part I, the proposal as it stands at present contemplates that at least $3,000 million would be raised over a five-year period, an average of $600 million a year. These proposed borrowings for IDA would be over and above the amounts required to be borrowed by the Bank in the same markets for its own purposes.

Governor Horowitz has pointed out, in support of the feasibility of borrowings in this magnitude, that fixed-interest obligations in excess of $35,000 million were sold in the markets concerned in 1962. With rising national incomes in the industrialized countries, it should be possible, he argues, to raise an additional $600 million for IDA; if necessary, some of the funds might be provided by diverting to the borrowings for IDA resources which would otherwise be devoted to the purchase of bonds designed to finance investments of lower priority.

There can be no doubt that if governments of the industrialized countries should prove willing (a) to give borrowings for IDA priority in access to their markets, (b) to provide guarantees fully satisfactory to the market, and (c) to permit the borrowings to be made at rates of interest attractive in relation to competing bond issues, the amount of funds envisaged could be raised without difficulty. However, in view of the considerations pointed out below, it cannot simply be assumed that the industrialized countries will agree to allow borrowings for IDA to be made under conditions assuring their success. On the contrary, such borrowings would pose difficult issues for the industrialized countries, which the presentation to UNCTAD may have dismissed too lightly.

For convenience of analysis, the various technical issues raised by

\[1/\text{E/CONF. 46/C.3/SR.20 (Provisional), p.3.}\]
the proposed market operations, although many of them are interrelated, are discussed separately under the following headings: (1) Absorptive capacity of the markets concerned; (2) interest rate considerations; (3) balance of payments considerations; (4) access to markets; (5) government guarantees; and (6) choice of borrower.

(1) Absorptive capacity of the markets concerned.

In considering the absorptive capacity of the market for borrowings under the Horowitz plan, it may be of interest to note at the outset the borrowing record of the Bank itself. The Bank, over its entire history, has sold bonds in the aggregate amount of $4,200 million in nine different markets. The largest total of Bank obligations outstanding at any one time was $2,530 million. The largest amount which the Bank ever borrowed in a single year (1957-58) is $627 million and the highest five-year average to date (1956-57 to 1960-61) is $315 million.

Over the next five years, the Bank will, for its own purposes, have to raise substantial amounts in the market. On the basis of the staff's best estimate of the likely volume of lending over this period, the Bank may need funds in the order of about $4,000 million to meet disbursements on its loans. During the same period it will also be called upon to meet about $1,400 million of maturities on its outstanding borrowings. Thus its total requirements for funds over the next five years are estimated to be some $5,400 million. Some part of this total will be financed through loan repayments, sales of loans, income, etc. But after account is taken of these sources of funds, it is estimated that there will remain some $3,000 million to be raised by borrowing, an average of $600 million a year over the five-year period, coincidently the figure suggested by Governor Horowitz as a minimum for borrowings under the proposal. However, since approximately
$1,400 million of this total would be used to retire outstanding obligations and would thus go back to investors, the aggregate of "new money" which capital markets would be called upon to supply for the Bank over the five-year period would be only some $1,600 million, an average of just over $300 million a year.

The question thus arises whether it is reasonable to expect that capital markets in the Part I countries could, or would be prepared, to absorb, annually, an average of some $1,200 million of borrowings for the Bank and IDA combined, of which about $900 million would be "new money".

On this issue, it is necessary to look separately at the U.S. and Canadian markets, on the one hand, and the U.K. and European markets, on the other.

Although the United States market is at present highly liquid, the government is attempting, at least temporarily, for balance of payments reasons, to discourage the outflow of capital through foreign issues floated in its markets by the device of an "interest equalization tax" on acquisitions by a United States person of long-term foreign securities (with certain exceptions). The measure was prompted by the fact that within an 18-month period the volume of new foreign issues reaching the U.S. market had more than trebled, rising from an average of less than $600 million a year between 1959-1961 to $1.1 billion in 1962 and to an annual rate of almost $2 billion in the first six months of 1963. The objective of the U.S. Administration, to which the tax and other proposals are directed, is to cut the outflow of capital into new foreign bond and equity issues back toward the range of $500-700 million a year (including new issues of Bank bonds purchased by U.S. residents) that prevailed from 1959 to 1961. It would be reasonable to assume on the


2/ Ibid, p.71. In testimony on the same measure, a year later, before the Committee on Finance of the U.S. Senate, Secretary Dillon noted that experience since the announcement of the proposed interest equalization tax indicated that purchases of foreign issues might be at the rate of "perhaps $600-800 million a year-close to, but still somewhat above, the rate that would have been considered "normal" prior to 1962". Hearings before the Committee on Finance, U.S. Senate, 88th Cong., 2nd Sess., on H.R. 8000 (1964) p.65.
basis of the Bank's experience (and putting to one side any possible application of the proposal's balance of payments criterion) that about one-half of all borrowing for IDA would have to be carried out in the United States. On this assumption, and on the further assumption that the United States Administration continues to pursue its objective of a maximum of some $600 million of foreign issues a year, about one-half of all foreign issues would have to be reserved for IDA if the total envisaged by Governor Horowitz were to be achieved. This would obviously create difficulties for other prospective borrowers in the United States market, including the Bank.

The Bank staff conducted an informal canvass of the view of representatives of the New York financial community concerning the volume of funds which it would be feasible to envisage raising in the United States and Canadian markets, together, on certain assumptions as to the scope of the government guarantees and the rate of interest. Having in mind that the interest equalization tax is a transitional measure, by its terms effective only through 1965, and that the United States hopes, by this and other measures, to bring its balance of payments into equilibrium within a reasonable period, the staff suggested that the judgments concerning the absorptive capacity of these markets be reached without taking account of balance of payments considerations or of the interest equalization tax or other governmental measures designed to discourage capital outflows.

The representatives expressed the view that the magnitude of borrowings contemplated by the proposal as it had been presented at UNCTAD was unrealistic. On the other hand, they were of the opinion that if bonds sold for purposes of the proposal had behind them a system of "joint and several" government guarantees and carried interest at 5%, the U.S. and Canadian markets together should be able to supply roughly $200-300 million annually. If the bonds were offered with an undertaking that outstanding borrowings under the
proposal would never aggregate more than the amount of the U.S. guarantee, they thought it should cost no more than $250-300 million. If, however, governments were prepared to give only "several" guarantees, it was thought that not more than $150-200 million annually could be raised in the U.S. and Canadian markets, even at interest as high as 5 1/2 - 6%; this was a more tentative conclusion, since there has been no market experience with a security of that character.

The situation in the U.K. and European capital markets is somewhat different. Taken all in all, market liquidity has been limited, sometimes principally because available savings have been sufficient only to meet domestic demands or have even been exceeded by these, sometimes because of the lack or inadequacy of machinery to mobilize and channel savings, sometimes both.

Whether out of governmental concern to assure that the requirements of domestic borrowers, public and private, are first satisfied, or in an effort to prevent demands of foreign borrowers from driving up domestic interest rates or for other reasons, the absorptive capacity of these capital markets for foreign borrowing is restricted by such factors as explicit controls on new foreign security issues, taxes on new securities, restrictions on the kinds of investments which may be made by institutional investors, etc; some markets have been entirely closed to foreign borrowing. And in addition there is the unintended but nevertheless effective restraint of the institutional shortcomings already referred to. While there is evidence of governmental steps to relax restrictions on foreign borrowings and looking to stronger and more efficient capital market mechanisms, such changes take time to institute and longer to have an impact.

1/ The question whether and to what extent governments would be likely to restrict the rate of interest carried by bonds issued for purposes of the proposal is discussed in the next subsection; the obligations which various types of guarantee would impose on governments are described below at p.

2/ See for a descriptive analysis of the major capital markets in Europe the study entitled "A Description and Analysis of Certain European Capital Markets". Paper No. 3 prepared by the U.S. Department of the Treasury for the Joint Economic Committee of the U.S. Congress, Joint Committee Print, 88th Cong., 2nd Sess. (1964).
There are two other relevant considerations. Some European countries, so far from being able to accommodate a greater external demand for capital, have been stepping up their own borrowing in outside markets, primarily to provide themselves with larger amounts of capital for establishment of new industries, to finance public expenditures and otherwise to support domestic growth. Second, there is already a queue of foreign borrowers for those markets in which borrowing is possible: other governments, developed and less developed, the Bank and other international institutions, and corporate borrowers whose demands are large and habitual. Borrowing for IDA would have to take its place in that queue unless, as a matter of policy, governments were prepared to accord a priority position to such operations.

[Data on European market views to be added]

1/ If available, it might be useful to indicate here or in an appendix recent data on foreign borrowing, in capital markets, by European governments. There is some material in the House Hearings cited above, and in publications of the Federal Reserve Bank of Cleveland. Perhaps it might be possible to suggest, by reference to the amounts floated in European markets (ex-Bank issues) in recent years, what the proposed borrowing for IDA would imply - i.e., what proportion some $300 million a year (Europe's assumed "share" of IDA borrowings) would bear to the recent annual averages of all borrowings (domestic and foreign, public and private) in European markets.
I have gone through the draft report very hurriedly, but a few points occurred to me. As the report indicates, the main questions are in the policy issues listed in Part III. Since the draft does not attempt to speculate about answers to these issues, its value is limited insofar as reaching a final conclusion on the proposal is concerned.

The most important "technical" issue is the amount of annual borrowings to implement the proposal that the U.S. and other governments would permit. I think that the estimate on page 12 of $200-$300 million annually for the U.S. and Canada may even be optimistic. Certainly, under an overall $600 million ceiling for foreign issues permitted in the U.S. market, anything like $300 million for this scheme seems too high. On the other hand, the report (page 10) seems to assume that the scale of IBRD requirements would not be affected by expanding IDA's operations under the Horowitz proposal. If the resources of IDA were doubled, I doubt if our lending to India and Pakistan through the Bank would be as large as it is now.

Two very important questions are the nature of the guarantee of the bonds that would be sold to provide the IDA funds and what effect guarantees by the "several" capital supplying countries would have on their own bilateral aid programs. It seems obvious, as the report concludes, that a collective guarantee would not be adequate. For example, bonds sold in the American market would require a specific U.S. Government guarantee. Since even with such a guarantee the U.S. Government itself could borrow at a lower rate, the ultimate cost of these funds would be higher than funds supplied out of normal Government appropriations. I do not know what the legal position is on the U.S. Government guaranteeing the obligations of international institutions.

The suggestion on page 19 that for balance of payments reason, part of the funds disbursed by IDA under this proposal might be tied "after international competition" would seem to raise difficult administrative problems since IDA would not know how much of each currency would be needed in advance of international competition.

Aside from the question of the willingness of the U.S. to permit substantial additional foreign borrowings in its markets and the touchy subject of guarantees, as the draft indicates the principal problem is whether the governments would make the long-run commitments required for the interest equalization fund. I have never thought they would, mainly because of legal and constitutional difficulties.

I have sent the document and a copy of this note on to Peter Wright.
OFFICE MEMORANDUM

TO: Ad Hoc Committee on the "Horowitz Proposal"    DATE: October 8, 1964

FROM: Richard H. Demuth

SUBJECT: Report on Horowitz Proposal

Attached is a first draft of a report on the Horowitz Proposal. As you will see, there are several references which cannot be completed until further research is done, but the paper has now reached a stage at which your views and advice would be useful.

I would like to have a meeting to discuss the draft on Wednesday October 14, at 3:00 p.m., in the DSD conference room, Room 846. Would you let my office know whether that time is convenient for you?

Messrs: Adler
      Avramovic
      Broches/Nurick
      Cavanaugh
      Cope/Collier
      Friedman
      Gordon
      Rist
      Stevenson

cc: Professor Mason
THE HOROWITZ PROPOSAL

A STAFF REPORT
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>1</td>
</tr>
<tr>
<td>Part I - The Proposal</td>
<td>4</td>
</tr>
<tr>
<td>Part II - Technical Issues Raised by the Proposal</td>
<td>9</td>
</tr>
<tr>
<td>A. Proposed market operations</td>
<td>9</td>
</tr>
<tr>
<td>1. Absorptive capacity of the markets concerned</td>
<td>10</td>
</tr>
<tr>
<td>2. Interest rate considerations</td>
<td>14</td>
</tr>
<tr>
<td>3. Balance of payments considerations</td>
<td>15</td>
</tr>
<tr>
<td>4. Access to markets</td>
<td>19</td>
</tr>
<tr>
<td>5. Government guarantees</td>
<td>21</td>
</tr>
<tr>
<td>6. Choice of borrower</td>
<td>25</td>
</tr>
<tr>
<td>B. Interest equalization fund</td>
<td>27</td>
</tr>
<tr>
<td>C. A possible alternative</td>
<td>34</td>
</tr>
<tr>
<td>Part III - Policy Issues</td>
<td>35</td>
</tr>
</tbody>
</table>
THE HOROWITZ PROPOSAL

A STAFF REPORT

INTRODUCTION

This study of the "Development Financing Plan" submitted to the 1964 United Nations Conference on Trade and Development by Mr. D. Horowitz, Governor of the Bank of Israel and Head of the Delegation of Israel to the Conference, has been prepared by the staff of the International Bank for Reconstruction and Development at the request of the Conference. The Conference recommended that a study be made by the Bank covering all aspects of the proposal, taking into account the points and observations made during the discussion in the Conference's Third Committee, and requested that the study be submitted to the United Nations, if possible by September 1964.

The staff of the Bank was not only able to draw upon the discussions in the Third Committee and upon relevant documents submitted to the Committee by the Delegation of Israel, but also had the benefit of discussions with

1/ In this study, the United Nations Conference on Trade and Development is referred to as "UNCTAD"; the "Development Financing Plan" is referred to as "the Horowitz proposal" or "the proposal"; the International Bank for Reconstruction and Development is referred to as "the Bank".

2/ The Third Committee of UNCTAD dealt with financial items on the Conference agenda. A portion of its report to the Conference (E/CONF. 46/133) is addressed to the Horowitz proposal (pars. 151-161).

3/ Annex A. IV.11 to the Final Act of the United Nations Conference on Trade and Development (E/CONF.46/L.28), adopted on June 15, 1964. The recommendation was adopted by 97 votes to none, with 12 abstentions. No roll call vote was taken and accordingly the specific abstentions are not officially recorded. By letter dated August 10, 1964, the President of the Bank informed the Secretary-General of the United Nations that it would not be feasible to complete the study in time for a September submission but that the Bank expected to be able to submit it by the latter part of 1964.
Governor Horowitz, who visited Bank headquarters, at the Bank's request, during August 1964. In the course of these discussions, a number of points relating to the proposal were amplified and clarified. In one significant respect - the magnitude of amounts to be raised under its terms - the proposal was modified. The terms of the proposal which are analyzed in this paper reflect the post-Conference discussions with Governor Horowitz; accordingly, they are not in all respects identical with the description of the proposal in the report of the Third Committee.

The purpose of the proposal is to bring about a "massive transfer" of capital to the less developed countries, over an extended period and on terms generally similar to those on which financing is now made available by the International Development Association (IDA). In fact, because the proposal contemplates that this increased capital flow would be administered by IDA, it is in effect a proposal for adding substantially, and on a continuing basis, to IDA's resources. As such, it takes its place beside other possible ways of achieving a very substantial rise in the volume of assistance made available on soft terms within a multilateral framework.

IDA's present funds are expected to be fully committed by the end of 1966 at the latest. If IDA is to have funds for commitment thereafter, it is necessary that machinery to that end be set in motion in the very near future. It is for governments to decide what amount of new funds is to be provided to IDA and by what method or methods those new funds are to be raised: whether, as in the past, by contributions of budgetary funds, whether in the manner proposed by Governor Horowitz, or whether through some combination of these and other possible techniques.

This study analyzes the Horowitz proposal as one means to the stated end. At UNCTAD's request the Bank is also examining a scheme proposed by the United Kingdom and Sweden for "Supplementary Financial Measures" which likewise calls for additional resources to be made available to IDA. It should be noted that the Horowitz proposal is addressed only to the method of raising funds for IDA and does not suggest any change in the use of IDA resources. The U.K.-Swedish proposal, on the other hand, suggests the provision of supplementary funds to IDA to enable IDA to engage in financing for purposes additional to those for which it now extends credits. The reports on these proposals, although they will be presented independently, should be considered together. In each case it is the Bank's objective, by analysis of the technical features of the particular scheme and by identification of the issues of policy it raises, to assist governments in evaluating the feasibility and desirability of the proposal as against various possible alternative courses of action.

The Horowitz proposal postulates acceptance by the developed countries of the need not only to continue but substantially to increase the scale of development assistance on terms placing a minimum burden on the balance of payments of the recipient countries. For purposes of the present study, this premise has been accepted. The circumstances which give rise to the need for aid on those terms are described in a Bank document submitted to UNCTAD concerned with the relationship between international capital flows.


2/ If governments decided to proceed with the proposal a number of specific operational matters would have to be considered - as for example the terms of IDA credits made out of funds raised under the terms of the proposal and the basis for distribution of such credits among the developing countries. Questions such as these, however, have no bearing on the merits of the proposal as a means of providing funds to IDA, and therefore they are not discussed in this report.
external indebtedness and economic growth. Work is in progress in the Bank and elsewhere seeking to estimate the probable order of magnitude of that need and governments will, of course, wish to take those estimates into account in their consideration of the issues raised by the Horowitz plan.

There are three parts to this study. Part I describes the principal features of the proposal. Part II analyzes and comments upon the technical and institutional issues raised by the proposal. Part III sets forth the principal issues of policy which the proposal presents for consideration by governments. While the study takes a position on certain of the technical and institutional issues, it does not seek to reach a conclusion as to the basic merits of the plan. Any such conclusion must depend essentially on the political judgment of governments with respect to the policy issues set forth in Part III.

In authorizing submission of this study to the United Nations, the Executive Directors of the Bank expressed no views, either in their own behalf or in behalf of the governments which appointed or elected them, concerning the issues which the study discusses.

PART I

THE PROPOSAL

Two basic premises underlie the proposal: first, that a satisfactory rate of economic progress for the developing countries depends upon capital

---


2/ As noted above, a number of sources have been drawn on for the description of the proposal, including discussions with Governor Horowitz. Documentation includes Israel's submission of the "Development Financing Plan" (E/CONF.46/C.3/15/Rev.1); the revised draft recommendation to the Third Committee (E/CONF. 46/G.3/L5/Rev.1); and the report of the Third Committee (E/CONF. 46/133).
inflows in amounts much larger than have heretofore been available and on terms appropriate to the recipient countries' repayment capacity; and second, that it is not politically realistic to expect development assistance on the scale and terms required to be made available through direct budgetary allocations.

To avoid the necessity of relying primarily on budgetary appropriations for the large amounts of development capital postulated to be required, Governor Horowitz proposes that the needed funds be obtained from the private capital markets of the developed countries. The technique would be as follows:

(1) The Bank or IDA, or some other international institution, would borrow funds on commercial terms from private investors. If the borrower is the Bank or some other international institution, and not IDA, the funds borrowed from the private market would be lent to IDA on the same terms on which they were raised.

(2) The borrowing in the private market would be made possible by a special system of government guarantees in which all of the industrialized countries which are members of IDA (i.e., the "Part I" countries) would participate, each in a proportion based upon its quota in the International Monetary Fund. The guarantee either would apply directly to the market borrowings or, if the Bank or some other international institution should be the borrower, might alternatively apply to loans made by the borrower to IDA of the proceeds of the market borrowings.

\footnote{In discussions with Bank staff, Governor Horowitz suggested that subscriptions to the capital stock of the Bank would be an equally appropriate basis for allocating guarantee liability.}
In order to reduce balance of payments constraints on the level of multilateral development aid, borrowing operations would be conducted to the extent feasible in those countries which, at the time, had a balance of payments surplus.

The funds raised by the borrowings would be lent by IDA on "soft" terms.

The difference between the market cost of borrowing on the one hand, and the charges on IDA credits made out of the borrowed funds, on the other, would be met out of an "interest equalization fund" to be created and maintained through annual appropriations by the industrialized countries, each country to assume a proportionate share of the annual aggregate.

As presented to UNCTAD, the proposal contemplated a scale of operations for both market borrowings and loans to the less developed countries in the order of $2,000 million a year over a 10-year period. Governor Horowitz subsequently suggested to the Bank staff that for purposes of this study the target should be an aggregate of $3,000 million of borrowings and loans over a period of five years. It is envisaged that loans out of the borrowed

1/ Governor Horowitz envisages that shares in the interest equalization fund would be allocated on the same basis as guarantee liability.

2/ An earlier version of the proposal submitted to UNCTAD was presented by Governor Horowitz at the 1962 Annual Meeting of the Boards of Governors of the Bank and IDA and was thereafter the subject of correspondence between Governor Horowitz and the Bank. This version likewise contemplated market operations and loans aggregating $3,000 million over five years. Governor Horowitz also spoke in the Third Committee of borrowings which might "after some years" reach $2,000 million a year.
funds would be made for periods up to 30 years, with interest at 1\%, and that there might be a 4% differential between this charge and the cost of borrowing, to be met out of the "interest equalization fund" mentioned above.

None of these terms, it is emphasized, is inevitable or fixed. They were presented to UNCTAD as illustrative only, and are set forth here to provide a frame of reference for examining, in the balance of this study, the technical, institutional and policy issues raised by the proposal.

As a background for that examination, certain preliminary observations may be useful at this point. In the first place, it may be noted that the principle of mobilizing private capital for development loans by an international agency is not new: Bank borrowings in various capital markets and the sales to investors of portions of the Bank's loans are applications of precisely this principle. The elements of novelty in the Horowitz proposal are (a) the proposed mobilization of private investment for development loans on "soft", rather than conventional, terms; and (b) the multiplier effect on the flow of capital to the less developed countries expected to be achieved by relatively small annual appropriations of public monies by the developed countries for deposit in the interest equalization fund.

A second preliminary observation is that, if the proposal should be adopted, it would mean -- in the absence of an agreed program of borrowings

1/ All IDA credits to date have been for terms of 50 years, with a grace period of 10 years and with amortization payments of only 1% per year for the next 10 years. The credits have been without interest but have carried a service charge of 3/4 of 1% to cover administrative expenses. It appears that by 1955-66 receipts from the service charge may equal or exceed administrative expenses, in which event the charge is to be re-examined with a view to possible reduction. The proposed terms of credits out of funds raised under the Horowitz proposal would therefore be somewhat "harder" than those of other IDA credits.

2/ Governor Horowitz spoke at UNCTAD of a 5\1/2\% rate of interest on borrowed funds, which would mean a 4\1/2\% differential. The report of the Third Committee, however (E/CONF. 16/133, 0.38), implies a 4\% differential.

3/ As of July 31, 1964, the Bank had borrowed a total of $4,080 million, and outside participation in Bank loans approximated $1,800 million.
over a period of years in each of the Part I countries -- a substantial change in the pattern in accordance with which resources are now provided to IDA by those countries. Under the present system, the amount of the funds provided to IDA by each Part I country is fixed pursuant to a negotiated schedule which is intended to reflect roughly the relative economic strength of the various contributors. Moreover, the funds are paid in instalments of a fixed amount annually over a period of years.

Under the Horowitz plan, on the other hand, the amount of the capital resources provided to IDA by the various Part I countries would -- again in the absence of a pre-agreed program of borrowings over a period of years -- depend upon which markets were, at any given time, open for borrowings for purposes of IDA and upon how much it was feasible to raise in each such market. The principle of distributing the aid burden on the basis of relative economic strength would be retained only with respect to the allocation of the guarantee liability and of assessments for the interest equalization fund. For its part, IDA would not be able to depend, as at present, upon a steady flow of contributed resources in a fixed amount, but would instead have to adjust its operations continually to the amount of resources which, at any given time, it was assured could be raised by market borrowings.

A final observation at this point is that the issues presented by the proposal may be viewed differently depending upon whether the funds which would be raised under its terms would supplement future increases of IDA resources by other means or would substitute, in whole or in part, for any such increases. Clearly, if the proposal were to be the single or the principal vehicle for making new funds available to IDA, the question of its feasibility and effectiveness in achieving its objective would assume greater importance than if it were designed as an additional, perhaps even an experimental, device.
PART II

TECHNICAL ISSUES RAISED BY THE PROPOSAL

A. Proposed Market Operations

As noted in Part I, the proposal as it stands at present contemplates that at least $3,000 million would be raised over a five-year period, an average of $600 million a year. These proposed borrowings for IDA would be over and above the amounts required to be borrowed by the Bank in the same markets for its own purposes.

Governor Horowitz has pointed out, in support of the feasibility of borrowings in this magnitude, that fixed-interest obligations in excess of $35,000 million were sold in the markets concerned in 1962. With rising national incomes in the industrialized countries, it should be possible, he argues, to raise an additional $600 million for IDA; if necessary, some of the funds might be provided by diverting to the borrowings for IDA resources which would otherwise be devoted to the purchase of bonds designed to finance investments of lower priority.

There can be no doubt that if governments of the industrialized countries should prove willing (a) to give borrowings for IDA priority in access to their markets, (b) to provide guarantees fully satisfactory to the market, and (c) to permit the borrowings to be made at rates of interest attractive in relation to competing bond issues, the amount of funds envisaged could be raised without difficulty. However, in view of the considerations pointed out below, it cannot simply be assumed that the industrialized countries will agree to allow borrowings for IDA to be made under conditions assuring their success. On the contrary, such borrowings would pose difficult issues for the industrialized countries, which the presentation to UNCTAD may have dismissed too lightly.

For convenience of analysis, the various technical issues raised by

the proposed market operations, although many of them are interrelated, are discussed separately under the following headings: (1) Absorptive capacity of the markets concerned; (2) interest rate considerations; (3) balance of payments considerations; (4) access to markets; (5) government guarantees; and (6) choice of borrower.

(1) Absorptive capacity of the markets concerned.

In considering the absorptive capacity of the market for borrowings under the Horowitz plan, it may be of interest to note at the outset the borrowing record of the Bank itself. The Bank, over its entire history, has sold bonds in the aggregate amount of $4,200 million in nine different markets. The largest total of Bank obligations outstanding at any one time was $2,530 million. The largest amount which the Bank ever borrowed in a single year (1957-58) is $627 million and the highest five-year average to date (1956-57 to 1960-61) is $315 million.

Over the next five years, the Bank will, for its own purposes, have to raise substantial amounts in the market. On the basis of the staff's best estimate of the likely volume of lending over this period, the Bank may need funds in the order of about $4,000 million to meet disbursements on its loans. During the same period it will also be called upon to meet about $1,400 million of maturities on its outstanding borrowings. Thus its total requirements for funds over the next five years are estimated to be some $5,400 million. Some part of this total will be financed through loan repayments, sales of loans, income, etc. But after account is taken of these sources of funds, it is estimated that there will remain some $3,000 million to be raised by borrowing, an average of $600 million a year over the five-year period, coincidently the figure suggested by Governor Horowitz as a minimum for borrowings under the proposal. However, since approximately
$1,400 million of this total would be used to retire outstanding obligations and would thus go back to investors, the aggregate of "new money" which capital markets would be called upon to supply for the Bank over the five-year period would be only some $1,600 million, an average of just over $300 million a year.

The question thus arises whether it is reasonable to expect that capital markets in the Part I countries could, or would be prepared, to absorb, annually, an average of some $1,200 million of borrowings for the Bank and IDA combined, of which about $900 million would be "new money".

On this issue, it is necessary to look separately at the U.S. and Canadian markets, on the one hand, and the U.K. and European markets, on the other.

Although the United States market is at present highly liquid, the government is attempting, at least temporarily, for balance of payments reasons, to discourage the outflow of capital through foreign issues floated in its markets by the device of an "interest equalization tax" on acquisitions by a United States person of long-term foreign securities (with certain exceptions). The measure was prompted by the fact that within an 18-month period the volume of new foreign issues reaching the U.S. market had more than trebled, rising from an average of less than $600 million a year between 1959-1961 to $1.1 billion in 1962 and to an annual rate of almost $2 billion in the first six months of 1963.

The objective of the U.S. Administration, to which the tax and other proposals are directed, is to cut the outflow of capital into new foreign bond and equity issues back toward the range of $500-700 million a year (including new issues of Bank bonds purchased by U.S. residents) that prevailed from 1959 to 1961. It would be reasonable to assume on the


2/ Ibid, p.71. In testimony on the same measure, a year later, before the Committee on Finance of the U.S.Senate, Secretary Dillon noted that experience since the announcement of the proposed interest equalization tax indicated that purchases of foreign issues might be at the rate of "perhaps $600-800 million a year—close to, but still somewhat above, the rate that would have been considered normal prior to 1962". Hearings before the Committee on Finance, U.S. Senate, 88th Cong., 2nd Sess., on H.R.8000 (1964) p.65.
basis of the Bank's experience (and putting to one side any possible application of the proposal's balance of payments criterion) that about one-half of all borrowing for IDA would have to be carried out in the United States.

On this assumption, and on the further assumption that the United States Administration continues to pursue its objective of a maximum of some $600 million of foreign issues a year, about one-half of all foreign issues would have to be reserved for IDA if the total envisaged by Governor Horowitz were to be achieved. This would obviously create difficulties for other prospective borrowers in the United States market, including the Bank.

The Bank staff conducted an informal canvass of the view of representatives of the New York financial community concerning the volume of funds which it would be feasible to envisage raising in the United States and Canadian markets, together, on certain assumptions as to the scope of the government guarantees and the rate of interest. Having in mind that the interest equalization tax is a transitional measure, by its terms effective only through 1965, and that the United States hopes, by this and other measures, to bring its balance of payments into equilibrium within a reasonable period, the staff suggested that the judgments concerning the absorptive capacity of these markets be reached without taking account of balance of payments considerations or of the interest equalization tax or other governmental measures designed to discourage capital outflows.

The representatives expressed the view that the magnitude of borrowings contemplated by the proposal as it had been presented at UNCTAD was unrealistic. On the other hand, they were of the opinion that if bonds sold for purposes of the proposal had behind them a system of "joint and several" government guarantees and carried interest at 5%, the U.S. and Canadian markets together should be able to supply roughly $200-300 million annually. If the bonds were offered with an undertaking that outstanding borrowings under the
proposal would never aggregate more than the amount of the U.S. guarantee, they thought it should cost no more than 4\% to borrow $250-300 million. If, however, governments were prepared to give only "several" guarantees, it was thought that not more than $150-200 million annually could be raised in the U.S. and Canadian markets, even at interest as high as 5\% - 6\%; this was a more tentative conclusion, since there has been no market experience with a security of that character.

The situation in the U.K. and European capital markets is somewhat different. Taken all in all, market liquidity has been limited, sometimes principally because available savings have been sufficient only to meet domestic demands or have even been exceeded by these, sometimes because of the lack or inadequacy of machinery to mobilize and channel savings, sometimes both. Whether out of governmental concern to assure that the requirements of domestic borrowers, public and private, are first satisfied, or in an effort to prevent demands of foreign borrowers from driving up domestic interest rates or for other reasons, the absorptive capacity of these capital markets for foreign borrowing is restricted by such factors as explicit controls on new foreign security issues, taxes on new securities, restrictions on the kinds of investments which may be made by institutional investors, etc.; some markets have been entirely closed to foreign borrowing. And in addition there is the unintended but nevertheless effective restraint of the institutional shortcomings already referred to. While there is evidence of governmental steps to relax restrictions on foreign borrowings and looking to stronger and more efficient capital market mechanisms, such changes take time to institute and longer to have an impact.

1/ The question whether and to what extent governments would be likely to restrict the rate of interest carried by bonds issued for purposes of the proposal is discussed in the next subsection; the obligations which various types of guarantee would impose on governments are described below at p.

2/ See for a descriptive analysis of the major capital markets in Europe the study entitled "A Description and Analysis of Certain European Capital Markets". Paper No. 3 prepared by the U.S. Department of the Treasury for the Joint Economic Committee of the U.S. Congress, Joint Committee Print, 89th Cong., 2nd Sess. (1964).
There are two other relevant considerations. Some European countries, so far from being able to accommodate a greater external demand for capital, have been stepping up their own borrowing in outside markets, primarily to provide themselves with larger amounts of capital for establishment of new industries, to finance public expenditures and otherwise to support domestic growth. Second, there is already a queue of foreign borrowers for those markets in which borrowing is possible: other governments, developed and less developed, the Bank and other international institutions, and corporate borrowers whose demands are large and habitual. Borrowing for IDA would have to take its place in that queue unless, as a matter of policy, governments were prepared to accord a priority position to such operations.

Data on European market views to be added

(2) Interest rate considerations

The absorptive capacity of the financial markets for any particular security depends, in part at least, on the yield offered; money is usually available at some price. It therefore becomes important to examine the considerations affecting the interest rate which might be carried by the proposed borrowings for IDA.

Governor Horowitz, in presenting the proposal to UNCTAD, suggested that the borrowings should be at a rate of interest comparing favorably with the rate on government bonds and with that on Bank bonds; at one point, he mentioned a possible rate of 5½%. This compares with an estimated present cost of money to the Bank of around 4½%. The highest rate Bank bonds have

If available, it might be useful to indicate here or in an appendix recent data on foreign borrowing, in capital markets, by European governments. There is some material in the House Hearings cited above, and in publications of the Federal Reserve Bank of Cleveland. Perhaps it might be possible to suggest, by reference to the amounts floated in European markets (ex-Bank issues) in recent years, what the proposed borrowing for IDA would imply - i.e., what proportion some $300 million a year (Europe's assumed "share" of IDA borrowings) would bear to the recent annual averages of all borrowings (domestic and foreign, public and private) in European markets.
ever carried thus far is 5%. In those Part I countries where long-term
government bonds have been issued, present interest rates range from %
to %.

It would obviously create difficulties for the governments of Part I
countries if borrowings for IDA were to be made in their markets at interest
rates so high that they would upset domestic interest rate structures
and spoil the market for governments' own borrowings (as well as making it
more costly for them to borrow abroad). This suggests that, as a practical
matter, the governments would not permit such borrowings if the yield were
more than some 1/4 - 1/2% above the rate carried in the given market by
government bonds. Thus, while it would in theory be possible to assure
that the goal of borrowing for IDA would be achieved by offering a high rate
of interest, in fact the interest rate would have to be essentially competitive.

(3) Balance of Payments Considerations

As noted in Part I, Governor Horowitz has suggested that, in order to
reduce constraints on the provision of development assistance through multi-
lateral channels, borrowings for IDA should take place primarily in those
countries which, at the time of the borrowing, have a surplus in their
balance of payments. The application of this principle might well affect
the amount of funds which it would be possible to raise for purposes of
the proposal.

To sell a substantial amount of bonds while minimizing operations
in countries in balance of payments difficulties would be feasible only when
there is a coincidence between balance of payments surpluses and market

1/ This rate was carried by a 1960 issue of 25-year U.S. dollar bonds, a 1959
issue of 10-year bonds payable in Belgian francs, a 1959 issue of 15-year bonds
payable in Deutsche marks, a 1961 issue of 15-year bonds payable in lire,
and a 1959 issue of 23-year bonds payable in pounds sterling.
liquidity, a condition which will certainly not always exist and which does not
in fact exist at present. In 1963, for example, 12 of the 18 countries which
are Part I members of IDA - Austria, Belgium, Canada, Denmark, Finland, France,
Germany, Japan, Kuwait, Luxembourg, the Netherlands and Norway - had balance
of payments surpluses. Had the proposal been in operation then, borrowing
in behalf of IDA might in theory have been carried out in any or all of
these countries. But several are among those countries described earlier
in this study which give priority to domestic capital requirements and limit,
in varying degree, foreign borrowers' access to their capital markets. Others
fall into the category of countries in which institutional inadequacies
would preclude the raising of any sizeable amounts. At the same time, the
principle that there should be little or no borrowing in countries with
a balance of payments deficit would rule out, now and presumably for the
immediate future, any substantial bond sales in the United States. Yet it
is the markets of the United States which could, in terms of liquidity, most
easily support additional borrowing operations of some magnitude.

A second possible consequence of applying this principle is that
certain of the Part I countries might over varying periods make no con-
tribution to multilateral assistance within the context of the scheme, except
to the extent of their assessments for maintenance of the interest equaliza-
tion fund. The size of those assessments is likely, however, to be relatively
small in relation to the amounts which could be supplied through the capital
markets of these countries. If the proposal were to be the only or the
principal technique for raising funds for multilateral assistance on soft
terms, the contribution of some countries might, accordingly, be in marked
disproportion to their ability to contribute in terms of real resources.
And among the countries which did provide capital funds, a new disequilibrium
might, in theory at least, be introduced: given two countries in a balance
of payments surplus situation, the one with a highly developed capital market
might be called upon to supply a larger amount of funds than the one with
an underdeveloped capital market insofar as concerns foreign issues.

The foregoing considerations suggest that, should the balance of payments surplus criterion be retained, the proposal may perhaps be capable of raising something less than the magnitude of funds contemplated by its sponsor; were that an undesirable or unacceptable consequence, strict application of the balance of payments surplus criterion would have to be sacrificed. Here again it would be relevant, in evaluating the implications of a lower potential for the raising of funds, to consider whether the proposal is to be viewed as a supplementary or the sole method of providing funds for assistance on soft terms. As was stated earlier, it is Governor Horowitz' view that an average of $600 million a year for a five-year period is the minimum which must be raised to make the proposal worthwhile. During both the discussions in the Third Committee and those in Washington he accepted the possibility that it might be necessary to depart from the balance of payments surplus criterion, and said that funds should be raised "mainly" rather than exclusively in countries with a balance of payments surplus. This would enhance the possibility of raising sizeable sums. However, the price would be a compromise of the potential effectiveness of the proposal to minimize the pressure of development aid upon the balance of payments of deficit countries in which borrowings are made.

From the standpoint of the proposal's objectives, the seriousness of such a compromise depends upon a judgment as to the extent to which, for those countries whose markets would be opened to borrowing for IDA by relaxation of the criterion, balance of payments considerations are in fact a restraint upon willingness to increase aid. In this connection, it may be noted that, although both the United States and the United Kingdom have

\[1/\text{E/CONF. 46/C.3/SR.14 (Provisional) p.6.}\]
been experiencing balance of payments difficulties in recent years, those
difficulties have precluded neither the continued provision of aid nor
increases in the level of assistance. The total net flow of official
financial resources (i.e., excluding private capital) from the United
Kingdom to the developing countries rose steadily from $205 million in
1956 to $440 million in 1961, falling back slightly to $421 million in
1962. The flow from the United States rose from $2,006 million in 1956
to $2,801 million in 1960, $3,488 million in 1961 and $3,542 million in
1962. And the U.S. Interest Equalization Tax Act mentioned earlier (78
Stat. 809, 827) exempts from the application of the tax the acquisition of
securities issued or guaranteed by less developed countries. This ex-
clusion "is designed to help those countries with chronic capital shortages,
urgent development needs, and limited ability to borrow on normal commercial
terms."

It is true that, in the case of both the United States and the United
Kingdom (?), the adverse balance of payments effects of the increased level
of assistance provided in recent years were substantially mitigated by tying
a large proportion of the aid to the procurement of goods and services in the
aid-giving country. No such tying is provided for in the Horowitz proposal,
presumably because IDA, like the Bank, requires that its borrowers, except

---

1/ Report by the O.E.C.D. Secretariat on the Flow of Financial Resources to
Less-Developed Countries, 1956-1962(C(64)32), p.12 (Restricted) [Can this
be cited?]

2/ Ibid.

3/ Annex to statement by Secretary of the Treasury Dillon, Hearings before
the Committee on Finance, U.S. Senate, 88th Cong. 2nd Sess. on H.R. 8000,
p. 71.
in very special circumstances, procure the goods and services to be financed on the basis of international competition, and "tied" funds may therefore not always be fully useable. The extent to which balance of payments considerations would restrain governments from giving access to their markets for borrowings for IDA, the proceeds of which were freely useable for procurement anywhere, in the magnitude envisaged by Governor Horowitz, is a matter of judgment on which the Bank staff can express no view. Should the restraint be regarded as substantial, however, it might be possible to provide that some portion of the proceeds of borrowings under the proposal, made in a country with balance of payments difficulties, should be available for use only to finance goods or services ordered in that country after international competition. So long as the portion so tied were not too large, such a provision, while creating some difficulties for IDA, would not constitute an insuperable obstacle to the proposal. On the other hand, unless a provision of this kind should be deemed necessary to enable the necessary funds to be raised, it would clearly be better not to incorporate it in the scheme.

(4) Access to markets

Although the proposal does not make this explicit, it may be assumed that the proposed borrowings for IDA would be made only with the consent of the government in whose markets the funds are to be raised. The Bank's Articles of Agreement contain a provision for such consent (Art. IV, Sec. 1 (b)) and, in order to protect their own markets, the governments of the Part I countries would doubtless insist on a similar provision in the Horowitz scheme.

There remains the question, which is closely related to the balance of payments questions just examined, whether, in order to make the Horowitz proposal feasible, provision would have to be made for an advance commitment by the government of each Part I country to permit up to a specified amount of borrowing in its markets in behalf of IDA over a given period.
It is true that, in the case of the Bank, governmental undertakings to permit access to markets were not incorporated into the Articles of Agreement, nor have governments at any time been asked to give such undertakings in advance of, and unrelated to, specific borrowing operations. This has not hampered the activities of the Bank. However, unlike IDA, the Bank started business with a substantial amount of paid-in capital, an increasing percentage of which has been released for use in Bank operations. Moreover, again unlike IDA, the Bank has been able over the years to add to its lendable resources substantial sums received by way of interest and principal repayments and from the sale of loans out of its portfolio. Because of the availability of these other resources, the Bank has never been wholly dependent upon borrowed funds. Instead, it has been able to schedule its borrowings to take advantage of favorable market conditions and, without limiting its lending program, to refrain from market operations at times when, or in countries in which, conditions were not propitious.

For reasons already discussed, the markets of the Part I countries may not be in a position readily to absorb borrowings for IDA over and above those required for regular Bank operations. The governments of those countries may therefore be reluctant to grant access to their markets for substantial borrowings on behalf of IDA, whether for balance of payments reasons or because the borrowings might divert investment funds from competing domestic or foreign requirements. The success of the proposal might accordingly be in doubt unless some advance commitments were made, at any rate by the major contributors to IDA, to permit at least a specified minimum of borrowings to be made in their markets. Indeed, without some such arrangement, it would be difficult for IDA to function, since it would have no assurance of the amount or timing of funds to be made available to it under the proposal. This would
be an almost insuperable handicap to effective operation should IDA have to rely on borrowings under the proposal as its only or principal source of funds.

The importance of this issue is magnified by the fact that development project financing normally involves a lag of some two (?) to three (?) years between the commitment of funds and their disbursement. Without assured access to markets for borrowings under the proposal, IDA could not responsibly make commitments except against funds already in hand. But for bonds to be issued several years in advance of the need for funds would be costly and governments might well be reluctant to consent to the sale of bonds in their markets if the proceeds were to be held idle for a period of years.

It would thus appear highly desirable that adoption of the Horowitz proposal be accompanied by some effective arrangement for assured access to the necessary markets at the necessary times. It is, of course, a matter of judgment for the governments concerned whether and to what extent such an arrangement would be politically feasible.

(5) **Government Guarantees**

The proposal correctly postulates that, whether the borrower be IDA, the Bank or some other international institution, a special system of government guarantees would have to be created to back the proposed market operations.

IDA, although authorized by its Articles of Agreement to borrow in the market, has never done so. Its capital structure, unlike that of the Bank, incorporates no provision under which the credit of its members would stand behind its obligations. The bonds of an institution whose purpose is to lend at long term to borrowers which by definition have limited or no creditworthiness for conventional loans would not, as a practical matter, be saleable unless they were fully backed by government guarantees acceptable to the market.

1/ Article V, Section 5 (i)
The same would be true of any new international institution created to serve as borrower for purposes of the proposal.

The need for a system of government guarantees would not be avoided by making the Bank, rather than IDA, the borrower. Such a system would clearly be essential if the Bank were to issue, for purposes of the proposal, a special bond which did not engage its own credit. It would equally be required, although for reasons less immediately apparent, if the Bank were to borrow against its own credit.

It is true that, because of the size of the uncalled 90% portion of members' subscriptions to the Bank's capital in relation to the Bank's outstanding indebtedness and because of its financial record, including the accumulation of sizeable reserves, the Bank now enjoys a borrowing capacity in excess of its immediate need for borrowed funds. However, should there be substantial defaults on Bank loans, the Bank's credit standing would certainly be adversely affected, even though holders of the Bank's bonds suffered no loss, being protected by the Bank's reserves and the 90% portion of members' subscriptions. In order to avoid defaults and consequent impairment of the Bank's borrowing capacity, Bank loans are extended only to borrowers which may be expected, under reasonably anticipated conditions, to be in a position to repay. IDA has neither a capital structure nor a loan portfolio which qualifies it under this standard as an appropriate borrower from the Bank. It is presumably for just this reason that Governor Horowitz suggested that, if the Bank should be chosen as the market borrower for purposes of the proposal, Bank loans to IDA of the proceeds of the market

---

1/ As of September 30, 1964, the Bank's outstanding direct obligations amounted to the equivalent of $2,490 million while the uncalled 90% portion of members' subscriptions, the principal security behind Bank obligations, aggregated $19,066 million, of which $13,795 million represented the uncalled portion of subscriptions of countries which are Part I members of IDA.

2/ As of September 30, 1964, the Bank's reserves stood at $897.8 million, of which $288.2 million was held in liquid form in a Special Reserve and the remainder, which was reinvested in the business, was credited to a Supplemental Reserve.
operations should be subject to a special guarantee by the Part I countries. Indeed, without such a special guarantee, any attempt by the Bank to borrow substantial funds against its own credit for purposes of lending them to IDA would undoubtedly jeopardize the Bank's standing in the market.

Governor Horowitz has pointed out that, whatever form the proposed guarantees by the Part I countries might take, it would impose on them only a contingent liability and would not require any budgetary appropriation of funds. However, since the ultimate borrowers of the funds to be raised under the proposal are the weaker of the developing countries, there is substantial risk that at least some of these countries may default on their obligations to IDA. In the event of such default, IDA, which has no substantial reserves, would in all likelihood have to call upon the Part I countries under their guarantees to make good the loss, whether those guarantees attached directly to IDA bonds or whether they applied to loans to IDA from the Bank. Since the proposal contemplates raising an aggregate of $3,000 million over five years, there is thus a possibility that substantial sums would have to be provided by the Part I countries pursuant to their guarantees, quite apart from their obligation to contribute to the interest equalization fund (see pp. below).

In considering the magnitude of their contingent liability under guarantees, governments should take account of the fact that some refinancing will be called for under the proposal and that the market would undoubtedly require that government guarantees extend as well to borrowings for refinancing purposes. The need for refinancing arises out of the fact that, under market conditions now prevailing and likely to continue in the foreseeable future, funds could not be borrowed for periods as long as 30 years, the term envisaged for IDA credits under the proposal. It would be necessary to retire each issue within

1/ Governor Horowitz contemplated the need for some refinancing. (E/CONF.46/C.3/2,p.2)
less than 30 years. This in turn means that repayment to bondholders could not be made wholly out of service on the IDA credits.

The presentation to UNCTAD did not discuss in detail the kind of guarantees which might be required or which governments might be prepared to offer. In theory, any of three types of guarantee would be possible: full joint and several guarantees; limited joint and several guarantees; and several guarantees. Under a system of full joint and several guarantees, each guarantor government would be independently liable for the full amount of each borrowing (or of each loan to IDA). Under a system of limited joint and several guarantees (the system embodied in the capital structure of the Bank), each government would be independently liable up to a specified amount. A system of several guarantees, on the other hand, would require each government to guarantee only a specified proportion of each borrowing (or loan); in the event of a default, it would be necessary to have recourse to each guarantor government.

A system of full joint and several guarantees would undoubtedly enable the largest amount of bonds to be sold at the lowest cost. However, there is no precedent for an international guarantee system of that scope, and it does not seem realistic to expect that governments would be willing to offer guarantees of this character; indeed, the proposal's reference to proportionate distribution of guarantees in accordance with IMF quotas suggests that this kind of guarantee was not in fact contemplated. On the other hand, a system of several guarantees, although it would impose the least liability on individual governments, would probably not be effective to support any sizeable volume of borrowings, or would do so only in conjunction with a rate of interest much higher than governments could be expected to permit. It can therefore be assumed that, as a practical matter, guarantees under the proposal would have to be joint and several in character.
A possibility suggested although not explicitly contemplated by the proposal would be for the guarantee of each government to extend only to borrowings made in its own market (or only to that portion of Bank loans to IDA representing funds raised in its market). The comment has already been made that some provision for governments' consent to borrowings in their markets is likely to be necessary. It might be provided that such consent would carry with it a guarantee obligation in an equivalent amount. This approach would have the advantage of enabling a government from time to time to review the extent of its guarantee commitments. But it would also have serious weaknesses. For one thing, it would deprive the scheme of the psychological advantages of collective responsibility. For another, each government's guarantee obligations would then be directly related to, and their extent dependent upon, the fact and the magnitude of market operations within its territories. The government of a country in whose markets no operations had been carried out within a given year for balance of payments reasons or limited market liquidity would be called on only for contributions to the interest equalization fund. There would be an extremely unequal burden of obligations as between such a government and one which had agreed to borrowings, thereby assuming a guarantee liability on top of its obligations toward the interest equalization fund. The proposal itself contemplates a more widely spread and equitable participation in the guarantee liability.

(6) Choice of borrower

Governor Horowitz has not tied his proposal inflexibly to particular institutional arrangements, saying that several alternatives were possible and that he did not want acceptance of the proposal to be made dependent on them. In theory, the borrower might be a new international institution created for the purpose, or the Bank or IDA.

\[1/\] Part II of this report.

\[2/\] E/CONF. 46/0.3/SR.14, p.2.
There would seem to be no justification for creating an entirely new international institution simply to approach the market. As between the Bank and IDA, Governor Horowitz' own preference would be the Bank, not only in the expectation that its standing and experience in world capital markets would facilitate the raising of funds, but also, apparently, in order to place at the service of the proposal some of the unused borrowing authority incorporated in the Bank's capital structure.

It is certainly true that the Bank could approach the market more readily than IDA; as a new borrower, IDA would have to qualify its obligations as legal investments in the capital markets in which it intended to borrow. But, as pointed out above, to make the Bank the borrower would not avoid the necessity for a new system of government guarantees. More important, there is the possibility that Bank borrowing for lending to IDA would adversely affect the Bank's credit standing and its ability to borrow for its own purposes. This was the point of view expressed to the Bank staff by representatives of the U.S. financial community. As noted earlier, there is a substantial risk that some of IDA's borrowers may default on their credits. Purchasers of Bank bonds sold to provide IDA with funds would not be prejudiced if, by reason of a borrower's default, IDA were not in a position to repay a loan from the Bank, because such repayment would, under the terms of the proposal, be guaranteed by the Part I countries. But representatives of the private financial community are strongly of the opinion that, even though bondholders would be fully protected, preservation of the Bank's market standing requires that the Bank's credit be kept separate from that of IDA and that the Bank in no way appear to be associated with a default on an IDA credit. Nor, in their view, would the risk of impairing the Bank's standing be eliminated if the borrowings were made against a wholly new system of government guarantees.

1/ An amendment of IDA's charter would also be necessary before IDA could borrow from the Bank. Article VI, Section 6 (a) of IDA's Articles of Agreement now provides that "The Association shall not borrow from or lend to the Bank."
rather than against the Bank's own credit. Moreover, they thought, it would be confusing and hence undesirable to create an obligation with which the Bank was associated but which would not be an obligation of the Bank itself.

The Bank staff concurs in these conclusions. Accordingly, in its judgment, as between the Bank and IDA it would be preferable, if the proposal were to be put into operation, that IDA borrow for itself. Apart from the important consideration that this approach would seem to offer the best chance of avoiding possible confusion between the credit of the Bank and the credit of IDA to the detriment of the former, it would have the merit of being a more direct and less complicated exercise. It would also be the most expeditious route to the ultimate objective of placing the borrowed funds in the hands of IDA. These factors would seem to outweigh the consideration that some effort would have to be expended to qualify IDA as a borrower in world markets.

B. Interest Equalization Fund

Creation of the proposed interest equalization fund raises no particularly difficult technical problems, although, because it involves an express or implied commitment to appropriate funds for a long period of years, it may pose a difficult political issue for some countries.

There is no way to compute in advance precisely what amounts would have to be contributed annually to the interest equalization fund for purposes of the proposal. The size of the required contributions would depend upon many unpredictable factors including, *inter alia*, the amount and the timing of the market borrowings made each year, the number of years the scheme continued in operation, the average market interest rate, the average interest rate charged by IDA, and the average length of time elapsing between market borrowings and disbursement of the borrowed funds by IDA. However, in order to have a rough estimate of magnitudes, the Bank staff has made a projection of requirements for the interest equalization fund on the following assumptions:
(1) $600 million would be borrowed each year for a period of five years at an average cost of 5%;

(2) Disbursements of IDA credits to the developing countries under the proposal would also aggregate $600 million annually and would coincide in time with the market borrowings;

(3) The IDA credits would be for a period of 30 years and would bear interest of 1% per annum.

(4) Market borrowings would be refinanced, at the same rate of interest paid for the original borrowings, to the extent necessary to carry outstanding balances on the IDA credits.

(5) the IDA credits would be amortized on the following pattern: a five-year grace period and repayment thereafter at the rate of 2½% per annum for the first 10 years and 5% per annum for the remaining 15 years.

On the foregoing assumptions, the required payments into the interest equalization fund would be as shown in the last column of the following table:

<table>
<thead>
<tr>
<th>Year</th>
<th>Payments into Interest Equalization Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$24 million</td>
</tr>
<tr>
<td>2</td>
<td>$24 million + $24 million</td>
</tr>
<tr>
<td>3</td>
<td>$24 million + $24 million + $24 million</td>
</tr>
<tr>
<td>4</td>
<td>$24 million + $24 million + $24 million + $24 million</td>
</tr>
</tbody>
</table>

It will be seen that, on the assumed conditions, the interest deficit to be met by the industrialized countries would be $24 million in the first year (Column 7) and that it would rise by that amount each year for the next four years, until the assumed period of grace on loans made out of the borrowed funds expired and repayments of principal began (Column 3), enabling

1/ It should be recognized that this is a wholly unrealistic assumption for the early years of the proposal, since considerable time would undoubtedly elapse between the first borrowing operations and the first disbursement of funds. The assumption has nevertheless been used for purposes of the projection because Governor Horowitz's objective is to have $600 million transferred each year, under his proposal, from the developed to the developing countries. Only by postulating an identical amount of borrowing and disbursement each year is it possible to reflect this objective and therefore to estimate the real financial burden implied by the proposed interest equalization fund.
<table>
<thead>
<tr>
<th>Year</th>
<th>Disbursements</th>
<th>Amortization</th>
<th>Principal outstanding</th>
<th>Interest on lending</th>
<th>Interest on borrowing</th>
<th>Interest deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>600</td>
<td>-</td>
<td>600</td>
<td>6</td>
<td>30</td>
<td>-24</td>
</tr>
<tr>
<td>2</td>
<td>600</td>
<td>-</td>
<td>1,200</td>
<td>12</td>
<td>60</td>
<td>-48</td>
</tr>
<tr>
<td>3</td>
<td>600</td>
<td>-</td>
<td>1,800</td>
<td>18</td>
<td>90</td>
<td>-72</td>
</tr>
<tr>
<td>4</td>
<td>600</td>
<td>-</td>
<td>2,400</td>
<td>24</td>
<td>120</td>
<td>-96</td>
</tr>
<tr>
<td>5</td>
<td>600</td>
<td>-</td>
<td>3,000</td>
<td>30</td>
<td>150</td>
<td>-120</td>
</tr>
<tr>
<td>6</td>
<td>15</td>
<td>3,000</td>
<td>30</td>
<td>150</td>
<td>150</td>
<td>-120</td>
</tr>
<tr>
<td>7</td>
<td>30</td>
<td>2,985</td>
<td>30</td>
<td>149</td>
<td>150</td>
<td>-119</td>
</tr>
<tr>
<td>8</td>
<td>45</td>
<td>2,955</td>
<td>30</td>
<td>148</td>
<td>150</td>
<td>-118</td>
</tr>
<tr>
<td>9</td>
<td>60</td>
<td>2,910</td>
<td>29</td>
<td>146</td>
<td>150</td>
<td>-117</td>
</tr>
<tr>
<td>10</td>
<td>75</td>
<td>2,850</td>
<td>29</td>
<td>143</td>
<td>150</td>
<td>-114</td>
</tr>
<tr>
<td>11</td>
<td>75</td>
<td>2,775</td>
<td>28</td>
<td>139</td>
<td>150</td>
<td>-118</td>
</tr>
<tr>
<td>12</td>
<td>75</td>
<td>2,700</td>
<td>27</td>
<td>135</td>
<td>150</td>
<td>-108</td>
</tr>
<tr>
<td>13</td>
<td>75</td>
<td>2,625</td>
<td>26</td>
<td>131</td>
<td>150</td>
<td>-105</td>
</tr>
<tr>
<td>14</td>
<td>75</td>
<td>2,550</td>
<td>26</td>
<td>128</td>
<td>150</td>
<td>-102</td>
</tr>
<tr>
<td>15</td>
<td>75</td>
<td>2,475</td>
<td>25</td>
<td>124</td>
<td>150</td>
<td>-99</td>
</tr>
<tr>
<td>16</td>
<td>90</td>
<td>2,400</td>
<td>24</td>
<td>120</td>
<td>150</td>
<td>-96</td>
</tr>
<tr>
<td>17</td>
<td>105</td>
<td>2,310</td>
<td>23</td>
<td>116</td>
<td>150</td>
<td>-93</td>
</tr>
<tr>
<td>18</td>
<td>120</td>
<td>2,205</td>
<td>22</td>
<td>110</td>
<td>150</td>
<td>-88</td>
</tr>
<tr>
<td>19</td>
<td>135</td>
<td>2,085</td>
<td>21</td>
<td>104</td>
<td>150</td>
<td>-85</td>
</tr>
<tr>
<td>20</td>
<td>150</td>
<td>1,950</td>
<td>20</td>
<td>98</td>
<td>150</td>
<td>-78</td>
</tr>
<tr>
<td>21</td>
<td>150</td>
<td>1,800</td>
<td>18</td>
<td>90</td>
<td>150</td>
<td>-72</td>
</tr>
<tr>
<td>22</td>
<td>150</td>
<td>1,650</td>
<td>17</td>
<td>83</td>
<td>150</td>
<td>-66</td>
</tr>
<tr>
<td>23</td>
<td>150</td>
<td>1,500</td>
<td>15</td>
<td>75</td>
<td>150</td>
<td>-60</td>
</tr>
<tr>
<td>24</td>
<td>150</td>
<td>1,350</td>
<td>14</td>
<td>68</td>
<td>150</td>
<td>-54</td>
</tr>
<tr>
<td>25</td>
<td>150</td>
<td>1,200</td>
<td>12</td>
<td>60</td>
<td>150</td>
<td>-48</td>
</tr>
<tr>
<td>26</td>
<td>150</td>
<td>1,050</td>
<td>11</td>
<td>53</td>
<td>150</td>
<td>-42</td>
</tr>
<tr>
<td>27</td>
<td>150</td>
<td>900</td>
<td>9</td>
<td>45</td>
<td>150</td>
<td>-36</td>
</tr>
<tr>
<td>28</td>
<td>150</td>
<td>750</td>
<td>8</td>
<td>38</td>
<td>150</td>
<td>-30</td>
</tr>
<tr>
<td>29</td>
<td>150</td>
<td>600</td>
<td>6</td>
<td>30</td>
<td>150</td>
<td>-24</td>
</tr>
<tr>
<td>30</td>
<td>150</td>
<td>450</td>
<td>5</td>
<td>23</td>
<td>150</td>
<td>-18</td>
</tr>
<tr>
<td>31</td>
<td>120</td>
<td>300</td>
<td>3</td>
<td>15</td>
<td>150</td>
<td>-12</td>
</tr>
<tr>
<td>32</td>
<td>90</td>
<td>180</td>
<td>2</td>
<td>9</td>
<td>150</td>
<td>-7</td>
</tr>
<tr>
<td>33</td>
<td>60</td>
<td>90</td>
<td>1</td>
<td>5</td>
<td>150</td>
<td>-4</td>
</tr>
<tr>
<td>34</td>
<td>30</td>
<td>30</td>
<td>-</td>
<td>2</td>
<td>150</td>
<td>-2</td>
</tr>
</tbody>
</table>
retirement of outstanding borrowings to start in the seventh year (Column 4). In the fifth and sixth years, the interest deficit is projected to reach a peak of $120 million and, with the assumed end of new borrowings, would gradually fall each year thereafter. There would be some deficit to be met out of the fund, however, for a period of 34 years.

The projection, it should be noted, assumes that it would not only be feasible to borrow but also to put out on loan through IDA an average of $600 million a year for five years. It would take some time, of course, to build up IDA commitments from the present annual level of around $300 million to the proposed level of $600 million; moreover, since disbursements inevitably lag behind commitments, a disbursement flow of $600 million would be realized only after commitments had been made at that level for several years. The projection above should therefore be taken to suggest the budgetary burden which might be imposed by the interest equalization fund as a result of operation of the proposal during some five-year period, a few years after the scheme had been launched, in which disbursements might realistically be envisaged at the projected level. It will also be recognized, of course, that if the scheme should prove successful and were therefore to be kept in operation for longer than the assumed five-year period, the requirements of the interest equalization fund would be correspondingly increased.

Governor Horowitz has suggested that the budgetary burden might be reduced through the annual transfer to the interest equalization fund.

1/ Investors in some countries, the United States for one, are accustomed to sinking fund provisions in the case of foreign issues. Should it be found necessary to incorporate such a provision as a condition of acceptability of bonds offered in the context of the proposal and accordingly to retire some of the bonds early, the pattern of borrowing suggested in the projections and the corresponding interest deficits would be somewhat different. In order not to complicate matters unnecessarily and because any assumption concerning sinking fund provisions would be arbitrary, the projections do not reflect the possible consequences of any such provisions.

2/ The assumption that borrowings would end in the fifth year is wholly arbitrary; some time limit had to be fixed in order to enable the projection to be made and for convenience the five-year period mentioned in Governor Horowitz's presentation to UNCTAD was adopted. In fact, if the scheme proved successful, borrowings would in all probability continue beyond five years, possibly at a higher level.

of some portion of the Bank's net earnings. The disposition of the Bank's net income is, under the Bank's Articles, a matter for decision each year by the Bank's Board of Governors, on the recommendation of the Executive Directors. Assuming that transfers to an interest equalization fund constituted under the proposal were to be considered a proper disposition of net income under the Articles (a question on which no view is expressed in this study), the possibility of such transfers being made is certainly not precluded. However, it is not possible to predict the level of the Bank's future net earnings out of which any transfer might be made or the amounts which it might be considered feasible and appropriate to transfer. It cannot, indeed, be taken for granted that there will always be net earnings remaining after allocation to reserves. For both legal and practical reasons, therefore, the Bank could not give an assurance of ability to contribute regularly to the interest equalization fund, either in principle or in terms of a specified amount. Moreover, to the extent that Bank net earnings, over and above reserve requirements, should be transferred to the interest equalization fund, this would correspondingly reduce the amount available for transfer by the Bank to IDA's general resources.

1/ Article V, Section 14.

2/ At the 1964 Annual Meeting, the Bank's Board of Governors approved the recommendation of the Executive Directors for a transfer to IDA, by way of grant, of $50 million, representing that portion of the Bank's net income for 1964 not required for reserves. In their report to the Board of Governors, the Executive Directors noted while their conclusions concerning the desirability of a grant to IDA had been reached with respect to net income for the fiscal year 1963-64 only, similar action might be appropriate in future years, although it would have to be decided upon with respect to each fiscal year in the light of all relevant circumstances, and particularly taking into account the need for additions to the Bank's reserves.
Governor Horowitz also suggested, in discussions with the Bank staff, that IDA itself might contribute to the interest equalization fund out of its own general resources. Any such transfer would of course reduce the amounts available for IDA credits. Moreover, should the Horowitz proposal be adopted as a substitute for direct government subscriptions, IDA's general resources would in due course consist only of special supplementary contributions and of repayments of credits outstanding. Sweden has thus far been the only country providing special supplementary contributions and there is no assurance that such contributions would continue if they were to be used for the interest equalization fund. Since no repayments are due on IDA credits for the first 10 years and thereafter only 1% per year for the next 10 years, such repayments, even if entirely allocated to the interest equalization fund, would not alleviate to any substantial extent the budgetary burden on governments.

Perhaps the most difficult political issue raised by the interest equalization fund is the long-term nature of the commitments implied. As the projection indicates and as pointed out above, it would be necessary to maintain the interest equalization fund for 34 years, on the stated assumptions concerning the duration of market operations and the term of IDA credits out of the borrowed funds. Some governments might be reluctant to accept an obligation to make regular allocations of budgetary funds for development assistance purposes over so long a period particularly since, for a time at least, the amounts would be rising. As a matter of presentation, budgetary appropriations for bilateral development aid are, for some of the principal aid-giving countries, on an ad hoc and normally annual basis.


1/ Smaller borrowings than have been projected or a lower cost of borrowing would reduce the size of the interest deficit. But neither circumstance would shorten the period for which the fund would have to be maintained.
While the assistance may in fact continue year after year, there is no advance undertaking that the appropriation of funds will be continued over an extended period and, in theory at least, appropriations could be discontinued at any time. Development assistance through the multilateral channel of IDA has, it is true, involved a commitment to make future payments of a specified amount, but the periods over which the payment obligations have run have been relatively brief: five years in the case of initial subscriptions, three for the recent replenishment. Thus, although it has been urged in support of the proposal that it would be politically more appealing than the past method of providing resources to IDA, it is possible that the long-term commitment aspect might in fact prove no less a political difficulty.

Governor Horowitz suggested to the Bank staff that, should this prove a problem for any Part I country, the difficulty might be overcome if a country's reasonably estimated aggregate obligations to the interest equalization fund over some period ahead were to be appropriated within a brief span of years, say three or five, rather than in smaller amounts annually over a long period. The amounts appropriated would be segregated in a special account, either in the custody of the country itself or of IDA, to be drawn upon annually to discharge the country's obligations to the interest equalization fund; moneys retained in the special account could be invested and the income credited to the interest equalization fund to reduce the aggregate amounts required from governments. It is a question for governments

1/ It is a matter for political judgment, too, whether it would be difficult to persuade legislatures of the desirability of an abrupt and radical change in approach to development aid, and whether problems might be created if the new approach should not prove satisfactory, either because insufficient funds were raised or for some other reason, and it became necessary to revert to former practices.
whether any such device as this would ease whatever difficulties the long-
term commitment might present.

C. A Possible Alternative

If governments see merit in the suggestion that the funds required
for development assistance on IDA-type terms should be obtained, in part
at least, from the private capital markets, they may wish to consider a
variant of the original proposal which has occurred to the Bank staff and
which would avoid some of the difficulties pointed out above.

Under this variant, the governments of the Part I members would
continue, as in the recent replenishment, to be the immediate source of new
funds for IDA. However, some portion of each government's contribution
might take the form of a loan to IDA. This loan would be made on the same
terms on which IDA credits are extended and would be repayable by IDA as
and when IDA itself received repayments on credits made out of the proceeds
of the loan.

Each contributing government would be free to select that method of
raising the funds to be lent to IDA which comported best with its own
situation -- through the budget or by borrowing in its own market. To the
extent that governments chose to find the funds by floating domestic bond
issues, the private capital markets would be providing funds for development
aid, just as under the original proposal. Governments would still be sub-
sidizing the differential between the market cost of borrowing and the charges
on IDA credits, as under the original proposal. However, governments could
probably borrow more cheaply in their own markets than could the Bank or IDA;
thus the differential which they would have to absorb would be smaller.

There would be no need for a new international system of governmental
guarantees or for arrangements insuring access to markets, since neither
the Bank nor IDA would be approaching the market for purposes of the proposal;
those governments which chose to find the funds for IDA in their markets would be borrowing against their own credit. And because neither the Bank nor IDA would be discharging the role of borrowing agency for purposes of the proposal, there would be no risk of impairing the Bank's credit standing.

PART III
POLICY ISSUES

Following are the principal policy issues raised for the consideration of governments by the Horowitz proposal. While these issues are listed separately, they are obviously interrelated and should be treated accordingly:

1. Is there agreement on the basic premise of the proposal that there needs to be a substantial increase in funds available for development assistance on IDA-type terms? If so, is there also agreement that it would be desirable for such increased funds to be entrusted for administration to IDA?

2. Assuming general agreement that IDA's resources should be substantially increased, would governments of the Part I members of IDA find it easier to achieve this objective

   (a) by employing the technique of the Horowitz proposal, thereby assuming the obligations inherent in the proposal (i) to create the requisite system of guarantees (ii) to accept a continuing liability to make payments into the proposed interest equalization fund and (iii) to agree to whatever arrangements may be necessary to assure access to their markets for bonds issued for purposes of the proposal;
   
   or

   (b) by raising the level of their budgetary contributions to IDA;
   
   or

   (c) by some combination of these two approaches?
This broad general issue involves the following subsidiary questions:

(a) Would governments of the Part I members consider it feasible for their capital markets to absorb borrowings for IDA in the amounts contemplated by the proposal?

(b) Would they regard advance arrangements to assure access to their markets as important or essential to the success of the scheme and, if so, would agreement to such arrangements present any special difficulties?

(c) Would it be necessary or desirable that arrangements be made to assure that each Part I member, over a specific period, provided a reasonable proportion of the capital funds to be raised (i.e., permitted an appropriate volume of borrowing operations)? If so, would it be politically feasible for the governments of these countries to make advance commitments to permit a stated level of borrowing over a period of years?

(d) Could the necessary funds be raised at interest rates which the governments of the Part I countries would find acceptable?

(e) Would the long-term nature of the obligation to provide moneys to the interest equalization fund present any serious political difficulty? If so, could the difficulty be minimized or overcome by appropriating the full amount of the projected liability to the fund within the first three or five years, instead of appropriating smaller amounts annually over a much longer period?

3. If governments of the Part I countries are uncertain whether, under conditions which they regard as politically acceptable, their capital markets could or would supply funds of the desired magnitude, would it nonetheless be desirable to try the proposal out as an experiment, or would the undertaking
of such an experiment be undesirable because of its possibly prejudicial effect upon the continuity and volume of developmental assistance provided in the present manner?

4. Does the variant of the Horowitz proposal described in Section C of Part II have any advantage either over the Horowitz proposal itself or over the present method of providing funds to IDA?