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CONFIDENTIAL

It is all fairly orthodox. The Treasury are content. I doubt if you need do more than glance through the paper. Agree that it can issue? 30/1

PRIME MINISTER

Yes

Economic Summit: Aid Study

For the next meeting of Personal Representatives (in London next month), each Personal Representative is due to put in, by 1st February, a position paper with his suggestions for the contents and approach of the report which we are due to make to Heads of State or Government for the Ottawa Economic Summit in July.

2. I attach the draft of the paper which I propose, subject to your approval, to contribute. It has been prepared in consultation with the Foreign and Commonwealth Office, the Treasury, the Department of Trade and the Department of Energy, who are content with it.

3. It also reflects the line agreed at a meeting between the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Secretary of State for Trade and other Ministers on 26th January. That meeting (which I attended) considered the exchange of correspondence and papers on development policy beginning with the Chancellor of the Exchequer's letter of 2nd September, 1980 and the Foreign and Commonwealth Secretary's minute of 20th October, 1980. I understand that the Foreign and Commonwealth Secretary may himself be reporting to you on the meeting; so I need say no more, by way of summary, than that it agreed upon:-

(i) the need to put aid in the wider perspective of total financing flows to the Third World, to encourage private investment flows and to ensure recognition of their growing contribution to development;

(ii) the need to encourage a realistic approach, by recipients of aid as well as donors, to the prospects for increases in aid flows;

(iii) the need to concentrate on making aid as effective as possible;

(iv) the need to encourage the oil-exporting countries to increase their aid and distribute it more widely;

(v) the need to avoid the risk of becoming labelled as the ringleader of a "hard-faced" line on aid in public and international discussion: other countries (notably Germany and France) are under the same policy constraints as we are, but would be very happy to see us in the lead and to make sure that we took the blame in the development world - to the detriment of our, and the benefit of their, political and trading prospects.

4. I am sending copies of this minute and of the draft paper to the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Secretary of State for Trade, the Secretary of State for Energy and the Minister for Overseas Development.

RTA

Robert Armstrong

30th January 1981

PROPOSALS FOR FRAMEWORK FOR PERSONAL REPRESENTATIVES' REPORT TO HEADS OF STATE OR GOVERNMENT ON THE AID STUDY

Note by the United Kingdom Personal Representative

The report should aim to put aid flows into their proper perspective.

2. Since 1970 official development assistance (ODA) as a share of total financial flows to less developed countries (LDC) has fallen from 43 to 35 per cent, while non-concessional flows have risen from 57 to 65 per cent; private flows have provided an increasing part of total non-concessional flows, and in particular bank lending has risen from 16 per cent of the total in 1970 to 21 per cent in 1979. On average LDCs finance the greater part of their investment from domestic savings. In agriculture, domestic policies on land ownership and farm prices play much greater parts than external aid. So aid flows are not the primary determinant of development, though for the poorest countries, especially since the latest oil price rises, increased aid will be needed if they are to achieve anything like adequate growth and build up their economies to the point where they can attract international banking finance and private direct investment.

3. Since 1970 aid as a proportion of GNP of the OECD countries has been remarkably constant at an average of about 0.35 per cent. This has been sustained despite successive oil price increases. In 1979 the industrialised countries had a net deficit of about $70 billion (and the LDCs a net deficit of about $50 billion), against a surplus of $120 billion for the oil exporting countries. In the coming years the needs of the industrialised countries -

i. to control inflation, which in many cases will mean restricting public expenditure;

ii. to develop alternative energy sources;

iii. to restructure their economies and so maintain employment, while keeping their markets open.

(all of these being objectives, the achievement of which by the industrialised countries will benefit the LDCs as well as themselves) mean that aid flows cannot be expected to grow significantly faster than GNP.

4. The report should therefore emphasise the importance of total financial flows in the development process and should recommend against any emphasis on aid targets, whether in the form of commitments to new targets or to reaching the 0.7 per cent target by any given date (or at least not by any date which is not acceptable to all the Summit countries).

5. The emphasis of the policy should be on -

i. putting aid in its proper perspective alongside private investment flows.

ii. making aid more effective;

iii. increasing the contribution to aid for the non-oil LDCs made by the oil exporting countries especially through the multilateral institutions.

iv. increasing so far as possible the proportion of the aid given by industrialised countries which can be given in ways which reflect the political objectives of OECD donors as well as the requirements of the recipients.

Aid Effectiveness

6. To make aid more effective means setting priorities.

7. In terms of distribution by countries, the first priorty (particularly given the prospects for slow growth in aid) is to concentrate it to a greater extent on the poorest countries. Over 1 billion people live in the low income countries (excluding China). During the past decade they have registered growth rates per head of only 1.8 per cent a year, compared with 3.5 per cent for LDCs generally and 2.7 per cent for industrialised countries. They benefit least from bank lending and private investments: in 1978 only 10 per cent of non-concessional flows went to them. Private bank loans and investment

are concentrated heavily on a small number of middle income countries, particularly in latin America. The OECD average for the share of bilateral aid going to the poorest countries is about 52 per cent.

8. Although priority should be given to the poorest countries, the better-off countries will continue to need some aid, where their development cannot yet be wholly financed by domestic savings and private banking and investment flows, or where aid is needed to supplement IMF financing for those in acute difficulties (eg Turkey, Jamaica).

9. In terms of sectors, special emphasis should be given to:-

i. agriculture and food production;

ii. energy production and conservation;

iii. population measures.

the object should be to identify the areas in which external assistance can best help the programmes of individual LDCs and to support those institutions best able to assist.

10. In agriculture the priorities should be to raise the productivity and income of smallholders and to increase, in particular, domestic food production. This will involve a whole range of activities, including research and planning, provision of credit and advice, and improving physical and marketing infrastructure, depending upon the particular circumstances. Technical co-operation has a particularly important role to play. LDCs should be encouraged to adopt sound policies on land ownership, farm pricing and credit. Capital aid for transport facilities can also be valuable to support rural development.

11. Food aid is justified in dealing with emergency situations such as famines or refugee problems, but countries should not become dependent on it as it can discourage the development of local food production.

12. As to energy, the emphasis should be on aid which contributes to the development of indigenous sources of primary energy and of renewable energy sources, and on the development of energy conservation; with particular reference to energy development which will contribute to the improvement of agricultural productivity. The Summit countries support the World Bank's programme, for increasing lending for oil, gas and coal production in LDCs, and in principle endorse the objectives for which the setting up of a new energy affiliate has been proposed.

The United Kingdom Government are ready to examine detailed proposals for a new energy affiliate, but would want to be convinced that setting up a new fund or institution would be the most cost-effective way of mobilising additional resources. They would particularly wish to consider -

i. the need to supply paid-in (as opposed to callable) capital;

ii. the extent to which non-OECD donors would be willing to make larger contributions;

iii. the effect on control.

The balance between multilateral and bilateral aid

13. Since 1970 the multilateral element in OECD aid (including contributions to EEC funds) has doubled to about 30 per cent. The biggest single cause has been successive replenishments of IDA which now accounts for 39 per cent of total multilateral aid by OECD. The United Nations group takes 26 per cent. For European Community (EC) countries aid channelled through EC aid programmes has also grown rapidly. IDA funds are directed to the poorer countries and to that extent contributions to IDA meet one of our suggested priorities. Current suggestions for the size of the next replenishment, due in 1983, would result in still further increases in the multilateral share of aid programmes. There will also be demands for replenishments of regional soft funds.

14. The Summit countries wish to see the general capital increase of the World Bank and the sixth replenishment of IDA carried forward and put into effect. But, if the Summit countries are to achieve the objective of increasing the proportion of their aid which is given bilaterally, they will need -

i. to induce the multilateral development institutions to approach future replenishments more realistically than they at present seem likely to do, and not to assume that traditional donors will be willing or able to support a continued increase in proportion to the growth of total aid;

ii. to induce other donors, notable members of OPEC, to take a larger share in new replenishments.

15. The institutions should also be encouraged to consider concentrating their efforts to a greater extent on the poorest countries. A new problem is that of China which will be eligable for IDA funds, thus virtually doubling the IDA constituency. This is bound to mean less for some others, notably India, if total resources are to be contained.

16. The Summit countries should, however, give their full support to the World Bank and other banks as effective vehicles for harnessing private funds to support well-planned development, and should discourage the formation of new bodies (such as the World Development Fund proposed by the Brandt Commission). While being willing to see the World Bank and other banks (and the IMF) adapt to new needs, the Summit countries consider it important that the institutions should maintain their financial soundness and that control must reflect national contributions. To weaken this would undermine their ability to raise funds and be damaging to the LDCs.

The United Kingdom Government considers that after the present general capital increase of the World Bank any further expansion of the Bank's lending capacity should be devised to minimise or eliminate further calls on the developed countries for paid-up capital. This could be approached in a number of ways, including altering or abolishing the ratio between capital and lending, greater use of callable capital, and co-financing. The United Kingdom Government is ready to envisage an increased role in the decision-making of the international aid institutions for members of OPEC who are willing to put up an increased share of their capital.

Increasing Aid Contributions by non-OECD donors

17. It should be a policy objective of the Summit and other OECD countries to encourage the oil-exporting countries both to provide more aid and to give more of the aid they give to a wider group of countries. To this end the OECD countries should be prepared to consider new financial mechanisms and should be ready to cooperate fully with members of OPEC who are ready to work with them and to respond to these objectives. They should also encourage contacts between OECD and OPEC aid agencies. The Summit countries should not embark on public criticism of the aid performance of the OPEC countries, as this would serve only to antagonise those of them (such as Saudi Arabia) who would have to be the main source of funds.

18. The Summit countries should draw attention to the poor aid performance of CMEA countries. There is no significant risk that this will goad them into expanding aid to the political disadvantage of the West by amounts or in ways which they would not otherwise adopt for their own political purposes.

Trade

19. For very many (and particularly for middle income) LDCs access to markets for their goods is of greater importance than aid flows. The Summit countries should for this reason (as well as for others) reiterate their intention of resisting pressures for increased protection. They should, however, emphasise that it will be easier for them to do so if the better-off developing countries move progressively and as rapidly as possible towards reciprocal objectives in the trade field.

Direct Investment

20. In the Area of direct private investment industrialised countries can help by removing outward controls, but the main need is for LDCs to maintain the right climate for investment. Bilateral investment protection agreements can be of value; so can part financing by the multilateral banks.

Finance of Development by the International Banking System

21. This note has concentrated, as no doubt the report to Heads of State of Government should, on aid by Governments and by official international

development institutions. Perhaps it should conclude with a reminder of the importance of finance for development in the better-off LDCs channelled through the international banking system, which is based principally on the industrialised countries. The purpose of official development assistance should be to enable poorer LDCs to build up their economies (as some already have done) towards the point where they can attract and service international banking finance for development. With GNP in the industrialised countries likely to grow only slowly, and aid as a proportion of their GNP unlikely significantly to increase, the availability of international banking finance will be of continuing and indeed increasing importance to the LDCs. The international banking system, as it recycles the financial surpluses of the oil-exporting countries, is in effect mediating the risks of a large and increasing part of lending to the LDCs, in respect both of terms and of spread of lending. The health and commercial soundness of the international banking system are of equal importance to investors in the industrialised countries, lenders in the oil-exporting countries, and borrowers in the LDCs, and it is in the mutual interest of all three groups of countries so to conduct their policies and affairs as to facilitate the flow of funds through the system and not to put its health and soundness at risk. That could well prove to be as great as any contribution which the three groups of countries can make to the continuing development of the Third World, and we ought to try to get all of them to recognise it.