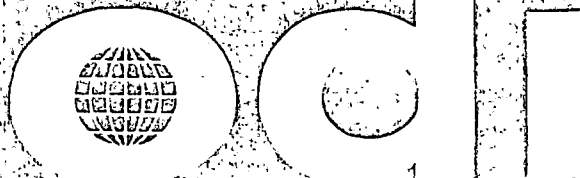


Overseas Development Institute

180 Piccadilly London W1

Tel: 01-493 2654



How the cuts in government expenditure affect aid

25 JAN 1968

A comment by the staff of the Overseas Development Institute
(for release at 0100 hours, Thursday, January 25)

Aid to developing countries is one of the items of public expenditure that will be affected by the government's economic measures. For two years, the aid programme is to be held to its present ceiling of £205m, and it will be required to absorb the full cost of devaluation.

This means that the real value of gross aid will fall by between 5% and 10%, equivalent to a cut of £10 - 20m, which may be compared with an overall cut in public expenditure of 2% in 1968/69 and 2.7% in 1969/70. It comes on top of the cut of £20m announced at the end of 1966, when aid was singled out for especially severe treatment.

The aid programme, therefore, has been required to carry its full share of the government's economies. In the political and economic circumstances surrounding the measures, this was inevitable. It was inconceivable that the government would at the present time have announced an increase in the sterling cost of the aid programme, which would have been needed to maintain its real value.

It is fair to say that the cut in aid has been as small as could reasonably be expected, and that it has been carried out in a manner which will do the minimum long-term damage to the aid programme as a whole. The decision to maintain the programme's sterling value means that political momentum will not be lost, and amounts to a strong re-affirmation of the government's commitment to provide aid for economic development. Strategic withdrawal is not to be accompanied by withdrawal from the international aid effort. It is clear that the Minister of Overseas Development put forward a strong case, and was given a sympathetic hearing by his senior colleagues.

In particular, it should be noted that the government has confirmed its decision to allow three items, expected to contribute to an increase in overseas civil expenditure in 1968/69, as additional to the overall aid budget of £205m. These are Britain's contribution to an international food aid programme, a possible increase in Britain's contribution to the International Development Association, and increased aid to Malaysia and Singapore to offset some of the loss caused by military withdrawal.

Treatment of these items as additional to the aid programme is justified, for the following reasons.

An increase in the British subscription to the IDA can only come as part of a negotiated increase in subscriptions from all the developed countries. The flow to Britain in export orders from these increased funds is likely to exceed the increase in the British contribution. If Britain were to offset increased subscriptions to the IDA with cuts elsewhere in the aid programme, there would be a windfall gain to Britain from international aid without any corresponding British contribution. The increase in the British subscription is likely to be between \$20m and \$32.5m (£8 - 14m), but this increase will not take full effect in 1968/69.

The food aid commitment is Britain's contribution under an international agreement to provide 4.5m metric tons of grain a year for three years. The agreement arose from the Kennedy Round negotiations in the GATT, and Britain's contribution should be seen as part of the price paid for the advantages that Britain gained. The cost in 1968/69 is expected to be £6m.

Increased aid to Malaysia and Singapore is in effect only a transfer from the defence budget, and should be seen in the context of an overall cut in Britain's contribution to these two countries' economies.

The government calculates that the specific costs to the aid programme as a result of devaluation will be about £10m, but this calculation appears to leave out the indirect loss of value resulting from increases in the prices of British goods bought with aid funds. On the other side of the calculation, since it refers only to gross aid, it leaves out the gain to developing countries in repayments of past loans denominated in sterling.

The purchasing power of British aid was automatically reduced by the devaluation of sterling. British aid spent on goods and services outside Britain now buys 14.3% less than before. Assuming that about £65m is involved, the loss is approximately £9m. (This calculation is not affected by the fact that some aid is spent on local costs by recipients which devalued in line with Britain, since the loss in foreign exchange for imports from countries other than Britain is the same, whether the recipients devalued or not.)

Aid spent on British goods will also buy less than before, because devaluation will lead to a rise in British prices, expressed in sterling. By the end of 1968, prices are expected to have risen by 3-7%, which is equivalent to a loss of £4 - 10m.

Because contractual obligations to international agencies are expressed in dollars, the sterling equivalent of British subscriptions - e.g. to the Asian Development Bank - is bound to rise by 16.7%, and this amount, say £3 - 4m, will have to be taken from other parts of the aid programme. Voluntary contributions, however, will be kept constant in sterling terms.

The burden of repayments and interest on past loans, which are denominated in sterling, will decrease by 14.3% for those countries which did not devalue. This, of course, only affects countries which have received aid in the form of loans rather than grants. Aid repayments from all countries to Britain are nearly £60m a year, so the gain to developing countries will be about £8.5m.

The net fall in the value of aid as a result of devaluation, therefore, will be £8 - 14m. (A more detailed analysis of the overall effects of Britain's devaluation on developing countries will be found in ODI's new survey, ODI Review - 2, British Development Policies, Needs and Prospects 1968, pp. 28-30, published today.) At a time when the developing countries are finding it harder and harder to secure adequate amounts of aid to support their development programmes, this fall will be widely regretted. But the political commitment which is implicit in the decision not to reduce the sterling value of aid gives ground for supposing that a restoration of the full value of aid, and then an increase, will be possible once the foundations for a resumption of Britain's own economic progress have been laid.

25 January, 1968