‘Not the needy, but the speedy ones’. German development aid and private investment in the Middle East, 1960-67

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Abstract

In this paper I shall try to explore the German development approach to fast-growing countries in the Middle East in the 1960s. A short description of that approach will be followed by case-studies which concentrate on the bargaining power of donors and recipients.

The evidence presented here is based on the loan contracts between the German development bank, Kreditanstalt für Wiederaufbau, and the Egyptian government between 1961 and 1967. These contracts were drafted, discussed and decided upon in the meetings of the German Interministerial Steering Committee for Development Aid and its Subcommittee on Capital Aid. The minutes of these meetings are kept in the German Bundesarchiv, Koblenz. I also consulted the minutes of the Development Assistance Committee (DAC) meetings in the OECD Archives, Historical Archives of the European Union, Florence, and printed material from the archives of Deutsche Bank, Frankfurt. My findings do not support the commonly held view that donor countries could impose the conditions for aid given to developing countries. At least the case of Germany shows that, because of its concerns about winning the Cold War and not alienating Arab states over its support for Israel, the

1 means West German, if not otherwise stated.
countries of the Middle East were negotiating from a position of strength. Even in the absence of these political constraints the fierce international competition in the private economy would not have allowed any donor or group of donors to dictate conditions of aid. The economic and political competition also thwarted attempts at coordinating aid between donors. My findings show that the German aid administration found it next to impossible to enforce contracts in cases of non-compliance by the recipient countries. Although Egypt got what it wanted almost all of the time in loan negotiations, it did not develop the way politicians on both sides had wanted it to. The evidence points to misguided planning (a ‘repeat of the Industrial Revolution in quick time’\(^2\)), misallocation of resources, and neglect of a wider institutional background to development, rather than tied aid or other ‘unfair’ conditions.

The evidence presented here on private and mixed public/private aid in the Middle East might help to focus the discussion on the widespread failures to maintain effective foreign direct investment, and on the institutional problems behind these failures.\(^3\)

The role of the private economy in official development policy

Foreign direct investment, the unruly child of development theories spanning back to the 18\(^{\text{th}}\) century\(^4\) and revived after World War II\(^5\), continues to claim a place in the world institutions’ thinking about development. The UN Millennium Report reiterates the importance of private investment for development, but also qualifies it in the light of past experience. Traditionally seen as a strong voice of developing countries, the

UN emphasizes the ‘needs-based approach to development assistance’\(^6\), and is openly critical of the IMF and the World Bank. Private investment did not get its own UN task force for the Millennium report, and is hardly mentioned in the task force report on trade. But the Millennium report does identify ‘fast-track countries’, supporting their claim to massive capital influx in order to ‘kick-start sustainable development’.\(^7\)

The OECD, on the contrary, while subscribing to the *Millennium Goals* (2005) and its predecessors, the *Monterrey Consensus* (2001) and the *Pearson Report* (1969), continues to see private investment as central to growth, development and integration into the global economy. The OECD puts the onus on recipient countries, and stresses the importance of foreign direct investment and the construction of an environment that invites and protects private investment.\(^8\)

For our purpose here the *MENA OECD initiative on governance and investment for development* is of special interest.\(^9\) This initiative was masterminded by the *Business and Industry Advisory Committee* of OECD, and especially its German member, the BDI (*Bund Deutscher Industrie*). At their first meeting in Munich, in February 2005, Donald J. Johnston, the Secretary-General of the OECD, sought to bring to this initiative ‘the lessons from the cradle of its birth, the Marshall-Plan. Money was important, but more important was the recognition that economic interdependence and cooperation would create and have created the Europe we see today’.\(^10\) It is surprising that no mention is made of the fact that in the 1960s a ‘Marshall Plan’ existed that should have created a Middle East very different from the one we see today.

In the light of these declarations one is tempted to ask: What is new? Not the euphoria about 3% growth in the Middle East and their new elites,\(^11\) not the Marshall Plan for the Middle East. We have been there before. Before we embark on a new aid and investment spree in the - then ‘speedy’, now ‘fast-track’ - Middle East, I think it is time to look at what happened the first time round.

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\(^7\) UN Millennium Report, p. 234.
\(^8\) OECD Statement to the Follow-up of the UN Millennium Declaration and Monterrey Consensus, 2 May 2005.
The German development approach 1960-1969

For the first years of German development aid, aid was supposed to be basically identical with private investment. The statement of a representative of the German Ministry for Economic Affairs in October 1960 says as much: ‘Public money can only accompany aid given through the private economy. The centrepiece of development aid is in any case direct private investment in developing countries.’

The discussion of a draft version of the ‘Annual German Aid Review’ for 1961, to be delivered to the Development Assistance Committee (DAC) of the OECD, reiterates this theme and expands on the three pillars of German aid: 1) aid is above all private, 2) the emphasis is on ‘aid for self-help’: ‘The real development work has to come from the recipient country. The recipient country is responsible for its economic and social development’, 3) the German government supports ‘as a matter of principle individual projects, in the form of loans at market conditions’. Two other important features of German development aid are a preference for bilateral aid, again to foster ‘responsibility’ on the recipient side, and a focus ‘on some regions, because of scarce resources’. This aid philosophy led to a focus on a limited number of fast growers, and among these the ‘speedy’ rather than the ‘needy’ ones, as Gustav Sonnenhol, the Ministry for Economic Co-operation’s (BMZ) representative to DAC, put it in May 1965. The recent crisis in the Middle East over Arab states recognizing East Germany and Israel establishing official relations with West Germany, had sparked a public debate in Germany about the nature and direction of foreign aid. The ensuing policy recommendations were: 1) Development aid would be granted in the first place to ‘friendly nations’, and to those countries which offered both ‘possibility and readiness’ for development.

The major part of German capital aid had indeed been provided to a few recipient countries (India, Pakistan, Turkey, Greece and the United Arab Republic [Syria and Egypt]), often through consortium arrangements. The basic approach in providing capital aid was through project assistance. In general, public funds were

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11 The Economist, 10 March 2005.
14 B 213/1519, LA 37, 6 Apr. 1962.
15 DAC/M (65)9, 50th session, 7 May 1965.
16 DAC/M (65)9, 50th session, 7 May 1965.
freely provided where they encouraged private activity.\textsuperscript{17} The countries regarded as ‘more hopeful’ received loans on so-called ‘soft terms’, in general for their infrastructure projects. Examples are the Euphrates dam project, which involved a loan of DM 350 million (US$ 87.5 million) to Syria, with a maturity of 25 years, at an interest rate of 3%, and with a seven year grace period. The bulk of aid to India, Pakistan and Egypt and all the aid to Turkey carried these same financial terms.

The drafts of other German Aid Reviews for the DAC highlight the primacy of private initiative even more, but successive reviews came to have more defensive undertones, owing to the other donors’ moving away from project to programme finance. All donors also felt under pressure from UNCTAD for tying aid to imports from their countries. The German Aid Review for 1962 starts out, as always, with ‘the priority of private efforts’. It states that ‘on the whole… public efforts are neither necessary nor appropriate.’\textsuperscript{18} The arguments made in favour of private efforts mirror the credo of the German \textit{Soziale Marktwirtschaft}, held to be responsible for Germany’s quick recovery after 1945. Aid to the developing countries should lead to ‘a free market economy and a balanced social structure.’ ‘Private efforts are best suited to the needs for development. …[Private entities] have the necessary experience, are flexible.’ A role for government aid is limited and basically restricted to certain projects: ‘because of the urgency of some problems, some government measures might be called for, to encourage and accompany private initiative, e.g. in building an infrastructure.’\textsuperscript{19}

The fact that ODA outweighed private direct investment plus government-guaranteed export credits during most of the 1960s\textsuperscript{20} shows that these statements were more about holding on to an ideal (an end to aid) rather than a description of actual aid-dispensing practices.

This ‘purist’ approach to development aid remained the official policy until 1967, when Gustav Sonnenhol, Chairman of the Interministerial Steering Committee for development aid and representative of the Ministry for Economic Co-operation at DAC meetings, summed up the debt problem of the developing world. The growing debt burden would soon result in a net backflow from developing countries: ‘The

\textsuperscript{17} DAC/M (63)13, 25\textsuperscript{th} meeting, 11-12 Dec. 1963.
\textsuperscript{18} B 213/1519, LA 37, 6 Apr. 1962.
\textsuperscript{19} B 213/1519, LA 37, 6 Apr. 1962.
backflow from developing countries is a specifically German problem. The US, France and England gave their aid on much softer terms and would not be confronted with a similar problem. German development policy was based on the idea that development aid should primarily be left to private initiative and that government help could only be subsidiary. But this “philosophy” carries consequences, which have to be borne.’ It is the representative of the German Development Bank (KW), Wilfried Guth, who points out in response to Sonnenhol that adhering officially to the net aid principle, as the DAC wants Germany to, would imply giving up any vision of an end to aid. Guth: ‘a further decrease in net aid has to be avoided’, but he is ‘against a formal recognition of the net aid principle’, because it would mean giving up on the long-term strategy of step by step replacing capital aid [ODA] by private aid.’ Adhering to the net principle ‘makes the debt position of a country uncontrollable and hinders the strengthening of a country’s transfer capability.’ But Guth wants more generous terms, ‘because there is a causal link between net aid and terms’. The Steering Committee decides, following Guth, ‘to adhere to the net principle internally, but not recognize it formally’. This is not the only case where internal practices would come to depart from the line officially taken.

Despite the official German resistance to the changes in aid philosophy demanded by DAC (here particularly the US) and UNCTAD, there were many changes made internally, with regard to aid implementation, that from very early on moved Germany closer to the other DAC members in terms of programme finance, interest-rate subsidies or other forms of budget support for the developing countries. Aid-dispensing practices will become clear in the cases discussed below.

The importance of the private capital market for German development aid

In April 1962 the German minister for the economy had raised the question whether Kreditanstalt, the German development bank, could contribute to aid with its own means. The answer given by two board members of Kreditanstalt, Guth and Martini, takes into account the fact that politicians plainly had little understanding of the

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money-generating mechanisms behind the novel enterprise of foreign aid and its often untried ways. The long letter from Kreditanstalt shows the intricate links between it and the rest of the German financial system. Kreditanstalt was linked to the private banks in two ways. 1) With regard to export credits, it was the private banks that approached Kreditanstalt on behalf of their clients from industry. The banks did the necessary paperwork for their clients and also provided guarantees for them to Kreditanstalt. Usually Kreditanstalt got clients passed to it that were too small for the big banks and too big for the savings and cooperative banks. Thus, Kreditanstalt played an important role in financing the German Mittelstand, and came to have financial tools tailored to small- to medium-sized firms operating in developing countries. 2) At the same time the German big banks formed the consortium that issued Kreditanstalt’s refinancing loans on the capital market. In doing so the big banks guaranteed Kreditanstalt vis-à-vis investors. Thus, Kreditanstalt had to be very concerned with its reputation for profitable business, because although it was the government’s development bank, it refinanced itself on the private capital market (much like the World Bank). Taking on even more tasks and thereby straining its resources could have jeopardized its credit standing in the markets. In fact, Guth and Martini pointed to a number of very recent undertakings that bound Kreditanstalt and the private economy even closer together: with regard to long-term export finance, Kreditanstalt ‘helps’ the private banks with their newly founded export credit bank, Ausfuhrkredit A.G. (AKA). The problem the private AKA faced in export finance was that it could hardly go beyond its rather short-term loans of 4-5 years, although there was international pressure from competitors, who offered ‘longer terms and better conditions.’ Kreditanstalt offered guarantees for longer-term export finance, 9-10 years. Guth and Martini pointed out that Kreditanstalt’s involvement in export finance was much bigger than stated in its balance sheet. ‘Apart from the 150 mio DM mentioned in our balance sheet of 31 Dec. 61 we are committed to a further 450 mio DM in this and the following years. On top of it we are committed to a further 764 mio DM in export credits, where we do not exactly know when and in which tranches they will be called. At the same time we are in continuous talks about export finance with the exporting firms and their house banks. These talks are not formally binding, but de facto they are, because the firms and banks negotiate on the basis of these talks

22 See also Deutsche Bank, annual report 1967.
with foreign clients, and these contracts in turn result in a firm commitment on our part.’ Thus, Kreditanstalt did not want to endanger its own credit standing by taking on yet more tasks.\(^{23}\)

**Cooperation between government and private sector**

The emphasis on private initiatives and the German development bank’s close link with, in fact dependence on, private markets beg the question of who determined German development policy and, if it was politicians and administrations, how it reached the companies and banks.

In the spring of 1961 the Interministerial Steering Committee started discussions about how to institutionalize cooperation with the private sector.\(^{24}\) The Committee envisaged a Government Advisory Council on development policy, made up of 20 people from politics, business and science, and two consultative committees, for capital aid and technical aid respectively. The creation of a government-sponsored ‘Entwicklungsgesellschaft’ also met with approval,\(^{25}\) leading to the foundation of the Deutsche Gesellschaft für wirtschaftliche Zusammenarbeit (Entwicklungsgesellschaft mbH) in Cologne, to coordinate with the private economy.\(^{26}\) It was, however, the ‘Arbeitsgemeinschaft Entwicklungsländer,’ composed of the German private-sector interest groups Bund Deutscher Industrie (BDI), Deutscher Industrie- und Handels-Tag (DIHT), Zentralverband des deutschen Handwerks, Gesamtverband des deutschen Groß- und Außenhandels and Bundesverband des privaten Bankgewerbes\(^{27}\), which became the major private partner of the government. The following discussion in the Subcommittee for capital aid highlights the weight of the Arbeitsgemeinschaft in government decisions regarding development aid.

In March 1963 the ‘Bundesstelle für Außenhandelsinformation’, a government agency, had approached the Subcommittee for capital aid with a request to publish a list of ‘development-aid tenders’ as an annex to its journal ‘Nachrichten für Außenhandel’. There ensued a discussion in the Subcommittee about whether to allow

\(^{26}\) B 213/1522, LA 62, 7 March 1963.
\(^{27}\) B 213/1516, LA 13, 2 May 1961.
this. The tender list would mention the projects that would most likely receive capital aid (approved of, but not yet negotiated, by the Kreditanstalt). The general public would only be informed once the loan contracts between the recipients and the Kreditanstalt were signed. Private companies would, however, be informed long before negotiations between the Kreditanstalt and a recipient country started, in general as soon as a recipient country approached the German government. It also worked the other way round: companies solicited business in developing countries and then contacted the German government. This was the procedure routinely followed in getting a development project under way: before the Subcommittee for capital aid put a project on the agenda, it first consulted the Arbeitsgemeinschaft Entwicklungsländer, then the country expert (Fachreferent) of the Ministry for Economic Affairs, ‘which in its turn is regularly in contact with the respective sectors of the economy.’ After the first discussion in the Subcommittee (after the Kreditanstalt had said the project is worthy of aid and the project study proper had been authorized), the Arbeitsgemeinschaft was informed of all cases which had made it to the Subcommittee’s agenda. After the government had given a firm commitment to finance a project and allowed the Kreditanstalt to conclude a loan contract, first the Arbeitsgemeinschaft was informed and then the government agency. The Subcommittee noted that so far ‘The Arbeitsgemeinschaft Entwicklungsländer has been told that the information is confidential and should be passed on only to interested parties or firms.’ It was de facto the Arbeitsgemeinschaft that decided who could bid for a development project contract. The Arbeitsgemeinschaft was powerful: it was heard first, before government entities, which consulted it. It possessed information advantages and could screen participants in the project. This would change to some extent with the publication of the annex,28 which would end the pre-screening of potential bidders and allow more firms to take part in bidding for contracts in developing countries. The Subcommittee decided in favour of publishing the annex on tenders.

The relationship between industry and government was at times strained. The ministries’ departments complained that German companies claimed to have secured export credit and other government guarantees in developing countries without ‘having previously talked to anybody’. This led to unpleasant diplomatic situations or

non-viable projects, as the Minister for Economic Affairs reminded the chairman of the Arbeitsgemeinschaft in a letter: ‘There are more and more cases where German companies, especially big companies, contract with clients in developing countries about the supply of production plants under the precondition of government-guaranteed credit and capital aid. Often the volume far exceeds the developing country’s ability to repay. In these cases it is impossible for the German government to give any guarantees or capital aid. If we decline we face diplomatic anger, if we give in we promote projects which fit our suppliers’ programs more than the developing country’s needs.’29

Another bone of contention was the quality of the Arbeitsgemeinschaft’s project reports to the Subcommittee for Capital Aid. The Arbeitsgemeinschaft was expected to check facts, form an opinion and then report to the Subcommittee. At times, the various ministries involved in development aid accused the Arbeitsgemeinschaft of just reiterating what various lobbyists had said, ‘without pronouncing a judgement of their own’.30

On the whole, however, relations were harmonious, according to a member of the Arbeitsgemeinschaft commenting on a special meeting with the Steering Committee: ‘If the discussion has not been as lively as I had hoped, this is certainly to be attributed to the fact that, in all important aspects of German development policy, there are no differences of opinion worth speaking of between the government and the private sector.’31

**Tied or untied aid? Official policy and procedures followed**

The official German policy was that aid should in principle not be tied to exports from the donor country. Germany did, however, resist the endorsement of strong anti-tying resolutions in the DAC. Two main reasons were given: 1) Germany regarded the anti-tying doctrine, especially pushed by the US, as hypocritical, and said as much in a stormy DAC meeting about the tying of aid in 1963: ‘The delegate for Germany asked, whether this was the appropriate time to adopt a resolution [against tying].

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29 B 213/1530, special meeting between Steering Committee and the Council of Arbeitsgemeinschaft Entwicklungsländer, 14 May 1965.
particularly since it might focus attention prematurely on a problem which is far from solution. He noted that the United States, the largest donor, had recently had to increase its aid tying because of balance of payments difficulties, and pointed to the inconsistency of adopting a resolution against tying, when the DAC’s largest donor was moving in the opposite direction.  

2) Germany did not regard tying as necessarily harmful, but as something, which, carefully governed, actually generates more aid. It shared this position with France in the DAC.  

In 1965 the German delegate to the DAC reiterated ‘that the statistics on tying did not reflect the true state of affairs, because a substantial amount of formally untied aid flowed back to German industry. He estimated that 70 to 80% of total aid came back, either because it was tied or voluntarily. Only if tying meant a restriction of purchases to a narrow range of goods was it harmful."

To ensure that tied aid would not distort competition, something Germany saw as vital for the effectiveness of aid, certain procedures, set up by the Steering Committee, were routinely followed. Recipient countries were obliged to tender, admittedly for the benefit of both, recipient and donor: ‘tender is in general better, because it guarantees an economic and frugal use of German capital aid. It is also mandatory, because otherwise German companies, which did not get orders, complain to the German government."

The guidelines for tender worked out in the Subcommittee for capital aid and approved of by the Steering Committee demanded there be international tender, if the agreements between the governments stipulated untied aid. If a recipient country wished tying (as happened in the Middle East in the 1960s, where especially the governments of Jordan and Syria on several occasions wanted to exclude American, British and French companies), there had to be a domestic tender in Germany. If tying meant orders given to specific companies without tender, then the prices and interest rates negotiated were checked against world market prices by ‘watchdogs’, set up by the recipient (rarely, as in Afghanistan, by the donor). The fact that most aid projects were subject to international tender does not mean that donors did not try to secure the orders for their domestic industry.

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31 B 213/1542, Sondersitzung, 5 July 1968.
32 DAC/M (63)7, 19th meeting, 24-25 July 1963. See also DAC/M (63)8, 20th meeting, 9 October 1963.
34 DAC/M (65)9, 50th session, 7 May 1965.
35 B 213/1491, Subcommittee capital aid, 2 Nov. 1962.
Occasionally there are hints in the committees’ meetings at behind-the-scenes bargaining to ensure the orders go to German companies. In fact, in July 1962 the Bundesbank had reprimanded the subcommittee ‘for overstepping its competence and creating clauses and annexes to contracts, which jeopardize the non-tying of aid.’ But the reality of untied aid seems to have been that all industrialized countries support their industry. As the Germans saw it, the former colonial powers had an extra advantage in that their recipients’ bureaucracies were still largely colonial. The case of Nigeria illustrates this point: The German government wanted to finance a road bridge over the lagoon of Lagos as a ‘German show case’, to be built by a German company: ‘Since we cannot publicly stray from our commitment to untied aid, we have to be quite ingenious, to secure orders for interested German companies, given that the Nigerian administration consists in large part of British citizens’. In these instances recipient countries used international competition to put pressure on German bidders for aid contracts. Interest rates and prices usually went down as a result of this. One example, which highlights also the Cold War competition, is the international tender for the town planning of Baghdad in October 1963. A Polish and a German company were runner-ups to winning the contract. According to the members of the Steering Committee, the Polish offer was ‘politically engineered’; it was 0.55 mio DM cheaper than the German offer. The Steering Committee decided to undercut the Polish offer with technical aid, but ‘without creating a precedent’.

A way to circumvent competition is corruption. The Steering Committee seemed to have dealt with this as well. Instances, where corruption is explicitly mentioned concern Afghanistan and Iran. In the case of the power station Mahipar in Afghanistan, corruption had not led to overpricing, since the conditions concerning prices and interest rates were in line with other projects and world market conditions. The situation in Iran was different. In August 1962 the Steering Committee had been approached by German suppliers to the Sefid Rud dam and a refinery for NIOC (National Iranian Oil Company). The German exporters had not been paid by the Iranian government in a long time. This seemed to have been a recurring problem.

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39 B 213/1517, LA 24, 13 Sep. 1961. Similar German complaints about Italian and French companies in Thailand. The companies’ bids for contracts in Thailand are said to be subsidized by their respective governments of up to 20%.
41 B 213/1543, LA 152, 20 March 1969, concerns the power station Mahipar.
Attempts at linking the disbursement of new aid to a settlement of outstanding debts seemed to have been complicated by the fact that: ‘In dealing with this whole, very delicate, set of problems, we have to take note of the fact that several German companies, ... secured the contracts only through very high bribes. This led to over-expensive fixed prices. In this regard the Iranian authorities have to be blamed as much as the German companies.’\footnote{B213/1520, LA 47, 31 Aug. 1962.} As a result the Steering Committee decided to not link the disbursement of new aid to the paying of outstanding debts.\footnote{B 213/1491, Subcommittee capital aid, 7 Sep. 1962.}

A look at the negotiations between the Kreditanstalt and recipient countries shows the discrepancy between actual loan conditions and the conditions spelled out in the Kreditanstalt’s so-called ‘standard contract’. The standard contract was approved of by the German government and was the basis of government agreements. Deviations from the standard contract as the ‘official line of development policy’ show the characteristics of the individual projects and the bargaining power of donor and recipient.\footnote{For the concept of bargaining power see R. Mash, Host country – foreign investor bargaining power and investment incentive provisions in multilateral investment agreements, University of Oxford. Dept. of Economics, Discussion paper series, no. 47, Oxford (University of Oxford) 2000). Egypt is a case in point: not signing the investment protection agreements required by the investor, is, according to Mash, a sign of high bargaining power.}

**Case study: Egypt**

Egypt had been at the top of Germany’s aid agenda in the 1960s,\footnote{B 213/1523, LA 65, 25 April 1963.} out of security policy reasons, but also as a fast grower.\footnote{see R. Owen, Ş. Pamuk, A History of Middle East Economies in the Twentieth Century, Cambridge Mass (Harvard University Press) 1999, esp. pp. 129ff.} In 1963 Egypt showed, according to the German minister for economic cooperation, Walter Scheel, ‘a relatively high level of development. … The preparedness for self-development is unmistakably great, and it has to be hoped that the Egyptians will master the difficulties of transition to an industrial era.’\footnote{B 213/1523, LA 65, 25 Apr. 1963.} Aid projects so far had been in the area of electric power, traffic and transport, agriculture and education.\footnote{\textsuperscript{49} B 213/1523, LA 65, 25 Apr. 1963.} Between 1959/60 and 1964/65, Egypt’s national income had, according to Owen and Pamuk, increased by 40%, industry had
grown by 50.2%. The sectors of the economy associated with the completion of the Aswan dam, such as electricity (128.6%) and construction (96.6%) grew even more impressively in this period.\(^{50}\)

In July 1961 the German government had signed an agreement with the United Arab Republic of Egypt and Syria about capital aid in the amount of 150 mio DM, to be dispensed over the next years to a number of infrastructure projects. (The union between the two countries lasted only until September 1961, and was dominated in all important issues, like development, by Egypt. The splitting up of the two made a rearrangement of the German aid package necessary. The former partners came to regard each other’s capital aid from Germany with envy and used perceived ‘imbalances’ in loan negotiations with the German government to get better conditions and more aid).\(^{51}\)

The first major project to be negotiated between September 1961 and May 1962 within the 150m frame was the construction of a dry dock in Alexandria. The Kreditanstalt, which negotiated the loans, repeatedly reported back to the Steering Committee about the eight clauses in the standard contract the Egyptians would not accept.\(^{52}\) The Steering Committee gave up on all eight clauses.

The first condition (which did not appear in the contract, but was part of an exchange of letters) to go was the insistence of the German Foreign Office that the shipyard neighbouring the dry dock not be built by countries from the Eastern Bloc. The related standard ‘transport clause’ was meant to ensure that transport, which would be paid for by German capital aid, would not fall to Eastern Bloc countries (notoriously difficult to enforce in the Middle East because of geography). This clause, which the Egyptians objected to, was abandoned, but came to haunt the Germans in later projects, when Egypt insisted on a ‘transport clause’ to exclude Israel.

The next standard clause about ‘control over the use of funds’ seemed at first to be ‘achievable, therefore insist’. Especially the Kreditanstalt regarded it as vital to the success of a project. It included a written agreement between the project sponsor, the Egyptian war ministry, and the German firms, led by Hochtief. The agreement stipulated that the Kreditanstalt had the right to visit the dock during construction, that Hochtief had to report half-yearly to Kreditanstalt and that Kreditanstalt could access all documents and accountancy pertaining to the project at Hochtief. The Egyptians, ‘sour and impatient’, objected. The German Finance Ministry, which kept insisting on the standard clause, in the end lost out to German politicians, who decided on a ‘soft, vague formula’. The only comfort for the Steering Committee was the fact that it had been promised that the guidelines on ‘control over the use of funds’ would be newly debated by the German government.

The third, so-called ‘negative’ or ‘non-discrimination’ clause, of equal importance for the Kreditanstalt as the upholder of sound banking principles, was meant to prevent Egypt from giving better securities to future creditors, who might offer cheaper terms. This was not even negotiated seriously. The Steering Committee’s decision very early on in the negotiations was terse and unambiguous: ‘abandon’. The Kreditanstalt eventually managed to include a phrase in the text, which was, however, so vague that it was not legally binding. The decision to abandon the ‘non-discrimination clause’ must have reflected the Committee’s realistic evaluation of international competition. Some examples will illustrate this:

In October 1960 an AEG-led consortium was bidding for a contract to build an extension to the power station Cairo South, part of the German capital aid project ‘Electrification of Lower Egypt’. The consortium had already raised 52.3 mio DM on the private capital market, guaranteed by the German government. The commercial interest rate was to have been 6.25%. Because of cheaper American and British competition, AEG had lowered its offer to 5% interest. AEG wanted the German government to subsidize the interest rate, to compensate the firms for the loss. The Steering Committee declined. Around the same time the Henckel-Werke had lost a contract for the export of a hundred Diesel locomotives for the Egyptian State Railways to General Motors.54

Kloeckner Industrieanlagen GmbH had undertaken the consulting for the iron and steel works at Helwan, another project that received German capital aid, since 1958. Egypt eventually wanted Kloeckner to extend its consulting to the entire Egyptian iron and steel industry. Kloeckner had hesitated over such a big task and asked for help from the German government, which was declined in June 1962. The immediate consequence of this refusal was that the American company Koppers got the contract. The Steering Committee acknowledged the fact that ‘The German economy thus lost an important area of activity in Egypt.’

The fourth clause in the standard contract, about ‘extraordinary circumstances’, also called the ‘political clause’, stipulated that ‘creditors can terminate the contract if extraordinary circumstances jeopardize the debtors’ obligations to fulfill the contract.’ What the German ministries had in mind here was nationalization of a country’s economy with subsequent expropriation of private property and change to a hostile regime. The Egyptians objected immediately and the clause was discussed controversially in the Steering Committee: it most likely ‘has to go, in order not to take away the effect of development aid,’ which was given ‘as a matter of principle without political strings attached.’ The representative of the Kreditanstalt, Wilfried Guth, and Sachs of the Foreign Office, wanted to remove this clause from loan contracts in future, moving it up one level to the agreement between the governments, but this time keep it as part of the loan contract so as ‘not to prejudice the other outstanding contracts with Egypt (for a total of 105 mio DM).’ The Steering Committee sent the issue back to the Cabinet, something that rarely happened. It was later decided to drop the clause.

Another ground for stopping payments and terminating the contract was if ‘a partner does not fulfill his payment obligations.’ This so-called ‘cancellation clause’ was also abandoned because of Egyptian resistance.

The standard clause insisting on the application of German law was also rejected by Egypt. Egypt insisted on the application of Egyptian law only, presenting as proof four contracts with Eastern Bloc countries. The only exception here was a contract with East Germany, where Swiss law had been the compromise solution. The Steering Committee tried ‘to stay firm, to accept at the utmost Swiss law.’ At this point the Committee asked itself ‘whether we want to negotiate further?’ The answer

being ‘yes’, it reiterated that it did not want ‘to lose Egypt to the Eastern Bloc’. The Committee later accepted Swiss law.

The standard clause on ‘commitment fees’ was to ensure that the recipient government shows its commitment to a project by a small down-payment in foreign exchange at the start of a project. Egypt refused successfully.

The standard contract also asked for an increase in interest by 2% for late amortization payments. Again, the Egyptians refused and the Kreditanstalt, following Swiss law, accepted a single penalty payment. We shall later see that there were numerous cases of non-compliance, when the German side found itself unable to enforce the terms of the contract. In the end the Kreditanstalt negotiated 13.8 mio DM in capital aid, with a duration of 14 years and an interest rate of 4%. 56

All in all, the loan contract for the dry dock in Alexandria had ‘allowed some deviations from the standard contract for project-tied loans to foreign countries… for foreign and defence policy reasons’, as the Steering Committee put it. It should have remained the exception, but Egypt now wanted this as the basis of all future contracts – the precedent Wilfried Guth of the Kreditanstalt had been afraid of. 57

Simultaneously with the preparation of the dry dock project the Kreditanstalt started on the ‘Nasser River Fleet’ project. 56 ships were to be built to transport iron ore from Aswan to the steel plant in Helwan, another German capital aid project, operated by Kloeckner. Several ports were needed for this ‘Nile fleet’, for a total cost of 31 mio DM, 20 mio of which were to be paid for by German capital aid (this was basically the foreign-exchange part of the project, which went into paying German suppliers). The Kreditanstalt considered the project a necessary precondition for the industrial opening up of Upper Egypt. It wanted to stick to the terms for infrastructure projects in the Governments’ Agreement: duration of 16 years, three years free of interest payments, and an interest rate of 3%. But the Treasury representative on the Steering Committee wanted higher interest rates, 5% for the ships and 3.5% for the ports, because it considered most parts of this project commercially viable, i.e. profitable. So why give it the special conditions and protections of capital aid? In the end the Steering Committee accepted the Kreditanstalt terms and authorized it to negotiate on the basis of 3%, but with strings attached: the Kreditanstalt should see to

it that ‘during the loan negotiations German industry gets considered more with regard to the shipbuilding contracts.’\footnote{B 213/1491, Subcommittee capital aid, 29 Sep. 1962.}

This is in my view a rather optimistic statement, since Nasser had just nationalized private companies, including foreign ones, amongst them the German \textit{DKD (Deutsches Kohlendepot)} in Port Said. The \textit{DKD} represented German shipping interests in the Suez Canal. According to the Steering Committee it ‘seems to be treated worse than American companies.’\footnote{B 213/1523, LA 64, 10 Apr. 1963.}

In February 1963 the contracts for the ‘Nasser River Fleet’ and another capital aid project, the ‘Cairo Sewage Syphon’ (2.9 mio DM), were being prepared by \textit{Kreditanstalt} and discussed by the Steering Committee. This time Egypt accepted the ‘total-funding clause’, the ‘Eastern Bloc clause’, excluding Eastern Bloc countries from supplying goods to parts of projects paid for by capital aid, and the clause about ‘cessation of payments in case of misappropriation of funds’. The acceptance of the Eastern Bloc clause was, however, tied to extending the transport clause to Israel, as the Egyptian Central Bank demanded in a letter to \textit{Kreditanstalt}: ‘on condition that there will be no Israeli interest in such means of transportation.’\footnote{B 213/1522, LA 59, 7 Feb. 1963.}

As regards the ‘commitment fees’, which Egypt did not pay for the Alexandria dry dock and therefore refused to pay now, the Steering Committee decided to ‘instruct \textit{Kreditanstalt} already now to retreat from their position at a tactically advantageous point in time.’\footnote{B 213/1522, LA 59, 7 Feb. 1963.}

Egypt this time accepted an interest-rate increase in the event of late payments, but only up to a total of 5%.

The ‘control over the use of funds’ clause was basically rendered toothless, because of Egypt’s insistence that the control be given to ‘Egyptian authorities’ (later, as a nod to German concerns, to an ‘Organization concerned in the U.A.R’). That was even less then the ‘soft, vague phrase’ that allowed \textit{Kreditanstalt} some sort of control through inspections in the case of the Alexandria dry dock.\footnote{B 213/1522, LA 59, 7 Feb. 1963.}

Similarly, the ‘extraordinary circumstances’ in a political and economic sense, allowing the partners to cease payments and terminate the contract, were, as in Alexandria, to be scrapped if Egypt had its way.

\footnotetext[58]{B 213/1491, Subcommittee capital aid, 29 Sep. 1962.}
\footnotetext[59]{B 213/1523, LA 64, 10 Apr. 1963.}
\footnotetext[60]{B 213/1522, LA 59, 7 Feb. 1963.}
\footnotetext[61]{B 213/1522, LA 59, 7 Feb. 1963.}
\footnotetext[62]{B 213/1522, LA 59, 7 Feb. 1963.}
And again, Egypt refused to acknowledge the non-discrimination clause, offering only a vague phrase in an exchange of letters, that would have no legal meaning.

On all six disputed clauses above the Steering Committee first decided to ‘negotiate hard this time’, but changed its mind in the same meeting: ‘we would hardly be able to survive this politically’. In the end the committee decided to ‘compromise on transport and commitment fees’. (We learn later that in order to get rid of the Israel clause, Germany accepted transport by Eastern Bloc countries.) Alexandria had had ‘softened’ conditions, and that made it harder to negotiate now. The further discussion of the investment climate reveals facts that should have had serious consequences for the aid relationship, like not signing an investment protection agreement, a ‘standard’ precondition for loan contracts. The Steering Committee took this with some fatalism: ‘the investment climate in Egypt right now is so bad that little would be gained by it.’ Then there was non-payment of suppliers’ bills, freezing assets of nationalized branches of German companies, not paying interest or amortization in time. What was the German aid administration to do? Stop payments as the contracts demanded? Tie the disbursement of new aid to the paying of old bills in a so-called ‘package deal’? The recipient countries in the Middle East responded with their own idea of a package-deal: if you don’t disburse new aid, we won’t pay your suppliers: ‘It has to be feared – and has already happened – that foreign governments or other authorities refuse to accept in supply contracts unconditional payment obligations. Instead they make the payment dependent on the flow of German capital aid.’

The Steering Committee seems to have been at a loss for a moment. It was obviously time to hand this whole mess to the German ministers and government - the politicians who had ‘caved in’ in the first place. So in March 1963 the German and Egyptian governments started talks aiming at solving some of the controversial issues. A month later the German minister for economic cooperation, Scheel, visited Egypt. During negotiations past misdeeds usually surface: Egypt had not fulfilled contractual obligations with one German company since 1957. Germany had threatened to hold up the disbursement of 10 mio DM capital aid in return, but ‘it did not work.’ The

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63 B 213/1519, LA 37, 6 Apr. 1962.
company in question was Raab-Karcher, a building material supplier and transport firm, which had a contract with the steelworks in Helwan for the shipment of coking coal (20 mio DM). Since the Egyptians had not paid, but suggested sending cotton instead, Raab-Karcher, having no use for cotton, had stopped shipping coking coal. Adding insult to injury ‘Helwan, in the meantime, has had coking coal delivered from Eastern Bloc countries,’ as the Steering Committee noted with great frustration.\(^6\)

Gustav Sonnenhol of the Ministry for Economic Cooperation summed up the situation, with maybe a hint of criticism directed at his employers: ‘Events in Egypt were already foreseeable in 1961. The situation then was even worse than it is now, especially with regard to the Egyptians’ involvement with the Soviet Union.’\(^7\) The Steering Committee, which was finally in a mood to get serious and hold new capital aid back, was, however, reigned in by the German government, which decided not to hold up capital aid, but change the coal supply contract with Helwan instead: the contractual obligation on Egypt to import coking coal was reduced and the duration of loans prolonged.\(^8\) So much for contract enforcement.

The bad investment climate and poor repayment habits of Egypt do not seem to have deterred the German government or private companies. The result of the government talks in April 1963 was an agreement on more capital aid: 230 mio DM for 12-16 years, at 3% interest; a ceiling of 250 mio DM on long-term export credits (9-10 years), administered by the Kreditanstalt; a government guarantee for an 80 mio DM loan to Egypt from German private banks; and government guaranteed export credits (5-7 years) up to 150 mio DM.\(^9\) Four years later some of these loans turned into bad debts. And again, the attempt at creating linkage between the paying of debts and the disbursement of new aid was thwarted in January 1967 for political reasons. The Treasury representative on the Steering Committee wanted to hold back the disbursement of 21.7 mio DM (the last tranche of the 230 mio DM envelope) and deny a new loan to the Nasser River Fleet, because Egypt was overdue 2.4 mio DM interest on the above-mentioned 80 mio DM loan from the DGZ (Deutsche Giro-Zentrale) since October 1966. The DGZ and other banks in the consortium wanted to terminate the contract – but the Egyptians did not even answer! Guth points to the inherent problem of all embargos: ‘German companies (specifically, BBC) have

\(^6\) B 213/1523, LA 64, 10 Apr. 1963.
\(^7\) B 213/1522, LA 63, 28 March 1963.
\(^8\) B 213/1523, LA 64, 10 Apr. 1963.
already started production. The contracts in question have long been signed by Egypt. They are held up in the Kreditanstalt because there is no agreement on the Nasser River Fleet. The Egyptians would not understand if all this were held up now. All projects concerned would become “development ruins” if the loans contracted were not disbursed.\textsuperscript{70} The June war of 1967 led to a moratorium on Egyptian interest payments ‘out of political motives’. Reported ‘hostilities’ in Egypt against German interests (because of Germany’s recognition of Israel) were ‘unimportant infractions’ and ‘no reason to reject Egyptian wishes.’\textsuperscript{71}

What happens when the German government gets serious? 1965 was the year that put tough talking to the test. In March 1965 the West German government had asked the Kreditanstalt to stop payments to Egypt, because Egypt had formally recognized East Germany, thereby violating the Hallstein doctrine. Two months later, on 13 May 1965, several Arab states, including Egypt, broke ties with West Germany after it established diplomatic relations with Israel. The next day, the German minister for development (later foreign minister) Walter Scheel met with the Steering Committee and the Arbeitsgemeinschaft Entwicklungsländer to soothe the companies’ fears of serious repercussions for the economy. He assured the members of the Arbeitsgemeinschaft, that ‘grave disturbances in German-Arab trade relations are hardly to be feared.’\textsuperscript{72} (A cornerstone of the Hallstein doctrine had been that a country that recognized East Germany as a sovereign state could not aspire to aid and investment from West Germany.) In July 1965 the opening of an Egyptian consulate in East Berlin, a further violation of the Hallstein doctrine, was imminent. At the same time there were still no official contacts between Egypt and West Germany because of the Israel issue. The Foreign Office wanted to hold back aid until the Cabinet had decided what to do. The attitude of the Kreditanstalt board member Guth shows that the Hallstein doctrine was obsolete, if it had ever worked. Guth mentions three projects that are ‘in the pipeline’. A bridge in Qena was supposed to get a 1.7 mio DM capital increase, to 8.8 mio DM; a ‘remainder’ of 19.8 mio DM had to be disbursed; the loan contracts for the sewer in Suez and the port in Tewfik were ready to be signed. Guth wanted to know whether all three should be held up, as the Foreign Office wanted. Could the bridge and sewer projects continue ‘if the Foreign Office

\textsuperscript{69} B 213/1523, LA 65, 25 Apr. 1963.
\textsuperscript{71} B 213/1539, LA 135, 29 June 1967.
confirms no worsening of the relationship?” The Steering Committee decided to continue with the bridge and the sewer. In February 1966 the question of what to do with ‘the remaining capital aid, while relations are broken off” arose again. Egypt had been promised mixed finance for a power plant in Asyut and substations in Lower Egypt. Since the German government would not guarantee the export credits on soft terms while it had no official relationship with Egypt, this important part of capital aid for the project fell through, at least for the moment. A way out of the dilemma would be to increase the private-finance part of the project. But Guth pointed out to the Egyptians that that would be more costly for them, implying commercial interest rates, shorter durations and much shorter grace periods: ‘mixed finance is nothing for weak countries or typical infrastructure projects.’ But since ‘last year the appropriations for long-term export credits had not been depleted, therefore the part of export credits in aid could be increased.’\footnote{B 213/1534, LA 115, 24 Feb. 1966.} In consultations about development aid in Washington in July 1966, the Germans reassured the Americans that although ‘some Arab states have broken off relations with Germany, …there have been numerous informal contacts about the possibility for new aid.’\footnote{B 213/1536, LA 123, 11 Aug. 1966.} In the case of Jordan, which had broken ties with West-Germany over Israel and followed Egypt to East Berlin in July 1965, the Steering Committee authorized the Kreditanstalt to contract loans ‘even without previous government agreements.’\footnote{B 213/1537, LA 130, 9 Feb. 1967.} So much for tough talking.

All in all the violations of the Hallstein doctrine by countries in the Middle East carried no serious consequences (neither did Germany’s recognition of Israel). The actual development policy followed during these moments of crisis ran counter to the official doctrine, which had led to the crisis in the first place. The Hallstein doctrine never really stood a chance with representatives of the private sector anyway: in January 1965 the Foreign Office called a meeting with the Government Advisory Council on development policy, to solicit more private money in view of stagnating public funds: “There is the impression in the world that the Germans are using their riches for themselves, while wanting to have little to do with development. … Such scarce development aid – only 200 mio capital aid commitment [ODA] for 1965 – cannot be an effective tool of German foreign policy [meaning the Hallstein
doctrine].’ The banker Hermann Josef Abs on the Council retorted: ‘You cannot buy friends, at the most rent them.’

Tentative conclusion

I attribute the difficulties in the German-Egyptian aid relationship to two chief factors: 1) a genuine mismatch in development goals (Soziale Marktwirtschaft versus Arab Socialism), and 2) the fact that security policy trumped development policy. The Cold War competition impeded the pursuit of any donor’s development strategy, because no single donor had any leverage in negotiations with Egypt. As I have shown, what Germany did not want to concede, Poland or the Soviet Union would offer. It would have taken concerted actions by donors from both blocs to break the habit of playing one against the other. I have found such donor cooperation for the 1960s only in the case of Afghanistan, between America, the Soviet Union and Germany (it is an intriguing, though apparently unique, case, which would merit further examination). In the private sector the playing of companies against each other can be of great benefit to the recipient country, but only in a country that has an incentive structure favouring development and some sort of accountancy. In Egypt private foreign investment met nationalized companies, controlled by 3 giant holdings, later 38 smaller ones, answering to the ministry of industry and the economy. The ministries controlled prices, investment decisions, foreign exchange, ‘all transactions with the outside world’, according to Owen and Pamuk. All criteria of economic efficiency seem to have been abandoned in favour of a single guideline: ‘reward loyal supporters of the regime.’

The Egyptian government siphoned off income from all sectors of its economy, mainly by buying entire harvests and productions at fixed, below-market prices. The inconsistencies between the ambitious Egyptian development plans (‘From the Needle to the Rocket’) and actual policies were familiar to the German aid administration. The Steering Committee and especially the Kreditanstalt communicated the innumerable contradictions between plan and action to German politicians, who then decided to ignore them for ‘foreign and defence policy reasons’.

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77 Owen et al., History, p. 132.
78 Op 132f, 143.
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79 Owen et al., History, p. 140.