Aid for development: Towards a constructive aid policy

MANZOOR ALAM

Aid, development, and reality

Underdeveloped nations must pitch their development efforts today in an international framework that is profoundly different from that of the previous decade. Development now takes place in the context of a multi-generational development gap and in an international environment dominated by economically advanced industrial nations.

However, before discussing these basic controversies which surround the issue, the origin of the aid relationship must be outlined. In the decade after 1945, a notion developed that rich countries should assist poorer nations in their development efforts. This was, first of all, the period in which a large number of countries achieved political independence. Both the former imperial powers and those nations which had no colonial background were forced into an awareness of the problems of poverty and international inequality and accepted, in different degrees, a common responsibility for their solution (Rodan 1961).

Second, aid was seen as a major weapon in winning the Cold War. Rapid economic progress of the less developed countries was viewed as an iron wall against the spread of Communism. Third, advances in economics also played an important role in the process of 'aid for development' (Ghos 1984). The success of monetary and fiscal policies in the developed nations helped in not only merely stabilizing economies at a high level of employment but also to achieve steady economic growth (Wood 1986).

The Marshall Aid Plan is viewed as history's most successful structural adjustment program. It contributed significantly to the rapid growth of Western Europe after World War II (De Long 1992). If an aid program could help Western Europe, why have they failed in poorer parts of the world ?

In practice, official assistance to poor countries for the purpose of promoting economic development is very much less impressive (Bhagwati 1985). In addition to this, the present financial flow goes in the opposite direction – from poor to rich!

For most developing countries, the balance of payments is significantly different in comparison with the rest of the world (Hayter and Watson 1985). After 1980, the developing world experienced a substantial deterioration in both current and capital account balances (The World Bank 1988). The main reasons for this decline included the dramatic fall in commodity prices including oil, the global recession of 1979–1982 and 1990–; indebtedness and a high level of interest payments, and the increased protectionism in the developed world against Third World exports (Todaro 1989; Government Institute of Economic Research 1991).

The accumulation of external debt is a common phenomenon of Third World countries, where domestic savings are low, current account payment deficits are high, and imports of capital are needed to augment domestic resources (Takagi 1989). However, lately, the external debt of developing countries has grown at a tremendous speed. For example, in the 20-year period between 1970 and 1989, the debt of LDCs grew from USD 68.4 billion to USD 1,283 billion, an increase of 1846 % (The World Bank 1988). The total external debt of developing countries more than doubled from USD 180 billion in 1975 to USD 406 billion in 1979, an annual increase of over 20 %.

On the other hand, external debt is increasingly based on nonconcessional terms. For example in 1971, about 40 % of the total external debt was on nonconcessional terms, in 1975 it increased to 68 %, and by 1979 over 77 % of debt was agreed on harder terms (The IMF 1988; Todaro 1989). Increasing indebtness and harder terms caused the tripling of debt-service payments, which rose from USD 25 billion in 1975 to USD 75 billion in 1979 (Ibid.). The most significant and persistent trend during the entire period of debt accumulation is the tremendous increase in the outflow of private capital from third world countries. Between 1976 and 1985, about USD 200 billion fled the heavily indebted countries – the amount represents almost 50 % of the total borrowing by the Less Developed Countries (LDCs) over the same period of time (Todaro 1989). In the years 1983-1988, for example, the outflow of capital from Latin American countries was USD 135 billion more than the inflow of capital (Government Institute of Economic Research 1991).

Thus, the increase in the debt-service obligation of the Third World countries and the sharp decline in lending by international banks in addition to the massive capital flight from these countries have turned a positive annual resource flow from developed to developing countries into a negative annual flow of billions of dollars from the Third World to the First World (Swell and Tucker 1988; The World Bank 1988). The overall reverse flow has now reached such a proportion that in reality it is the poor countries who have been aiding the rich countries!

The reality is that rapid and sustained economic growth is indispensable for the Third World's development. Ignorance, hunger, and diesease cannot be overcome unless production and services are greatly increased. Only economic growth can create the resources for the improvement of human well-being. Yet, it must be emphasized that economic growth measured by gross national product (GNP) is not synonymous with development. A broad assessment of the pace and direction of change and of its impact on the well-being of people would provide the necessary guidance (Commonwealth Secretariat 1984). Social questions and social relations should also receive proper consideration. Thus, development should be considered as a process of self-reliant growth, achieved by the participation of the people acting in their own interests as they see them, and under their own control.

Millions of people are suffering from hunger, malnutrition, disease. Millions are illiterate. More than 50 % of the world's population has a per capita gross national product of less than 3 per cent of the per capita GNP of the 15 per cent of the world's population living in the industrialized nations. The Third World countries, which have 75 % of the world's population, have a GNP of less than 20 % of the world's total (Todaro 1989). One may safely predict that the gap between rich and poor countries is bound to grow in both absolute and relative terms in the forseeable future. A crisis in international relations is almost inevitable if the international economic system is incapable of providing an effective reduction of inequality among the world's nations (The Report of the South Commission 1990).

Aid-related controversies and some directions

Aid implies the idea of a gift, of assistance rendered, of unilateral transfer. However, the flow of resources to LDCs includes a number of transactions that are strictly commercial and in which there is no presumptions of a unilateral advantage to the recipient of the flow. Export credits, or loans made by governments or international organizations (e.g. the World Bank), at more or less commercial rates of interest (e.g. 8 % per annum) without grace periods, should not be called aid. Even the non-commercial flow of resources – the 0.7 per cent U.N. aid target – falls within too wide a definition of what should be called aid. Purely commercial motives and purely humanitarian motives are only two motives among a variety of others (e.g. military motive, diplomatic motive, cultural influence motive).

The common concept of foreign aid encompasses all official grants and concessional loans, in currency or in kind, that are broadly aimed at transferring resources from developed to less developed nations on development and/or income distributional grounds. On the other hand, some economists have defined foreign aid as any flow of capital to LDCs should be non-commercial from the point of view of donor, and it should be on 'concessional' terms, that is, the interest rate and repayment period for borrowed capital should be 'softer' than commercial terms (Bhagwati, 1972). Current observation indicates that the present aid policy is ill-designed to serve any potential role in the Third World's rapid economic growth (Strand, 1992). So, it is not surprising that so much scepticism has arisen about the value of aid as an instrument in promoting economic development in the poor countries.

However, within the controversial implication of aid as an agent of development, it is necessary that aid should be directed in promoting structural changes in the world economy. Support should be given to increase the processing of primary commodities in the poorer countries; to increase mineral exploration and development in the LDCs; to create buffer stocks and other measures to stabilize and improve primary commodity prices; to increase food production and rural development; and to strengthen the technological capacity of LDCs (Singer and Ansari 1988; Todaro 1989). Proper attention should also be paid to reducing the ever-widening international economic gap between rich and poor countries. The contribution of rich countries to the development of Third World nations will have to be geared to the actual development needs of the poor countries and not to serving the political and economic interests of the rich countries themselves (Highland, 1990).

The tying of aid has given rise to much controversy. 'Aid' can be tied either by 'source' (i.e. loans and grants have to be spent on the purchase of donor country goods and services) or by 'project' (funds can only be used for a specific project). The main arguments for 'project-tied aid' are: the donor country or agency may control the proper execution of the project; the donor can maintain some kind of leverage and control over the money; it makes it easy for the donor to combine financial aid with the proper technical assistance required for the project etc. There are also many arguments against project-tied aid, but in any case, the real value of the aid is reduced because the specific source is likely to be an expensive supplier or the project itself is not of the highest priority. It may also impose an additional real resource cost – in the form of higher unemployment etc. (Todaro 1989.)

Aid for development

The economic gap between rich and poor countries may widen by between three and four times in the next thirty years. The political and economic consequences of this growth in inequality are likely to be immense. A realization of the seriousness of this problem is vital for global stability and prosperity (Krueqer 1993). One of the main instruments is a 'massive transfer of resources' from rich to poor countries for reducing the income distribution between rich and poor countries (Abott 1983). In addition to the need to expand foreign aid, the distribution of its cost also has to be carefully checked to increase the effectiveness of the aid plan (Pietrobelli, 1992). There are several areas, for example, in which such a reform plan would be useful. These relate to 1) the tying of aid, 2) the issue of multilateral vs. bilateral aid, 3) the difficulty of repayment of aid, 4) the commitment of aid for longer periods of time, 5) adjustment of the international economic order.

The huge amount of external debt of LDCs has created an enourmous debt burden, and the IMF's harsh adjustment programs have left their economies weak and vulnerable (Hayter and Watson 1985). A solution of the debt crises will require in the long run a genuine willingness on the part of lenders to restrain the interest rate paid on existing loans and a substantial expansion of official lending from the governments of developed countries and the multilateral lending agencies. It also requires a major reduction or elimination of all kinds of tariff and non-tariff trade barriers by developed countries against the exports of developing countries and a reconstruction and reform of the economic system of the developing countries (Todaro 1989).

Developing countries are often critical about the existing global market structures. Their criticism is focused, for example, on the substantial imbalance in the distribution of international monetary reserves. Seventy percent of the world's population received less than 4 % of the international reserves during the first half of the 1970s. Rich nations also benefit disproportionately in the distribution of the value-added products traded between themselves and the poor nations, and they practice a restrictive market policy against developing nations (World Bank 1988).

Even a constructive aid mechanism can be effective only if the present international economic system that has created those imbalances is replaced by a just new international economic system.

Towards a constructive aid policy

There are two ways of improving inefficient aid systems. The simplest way is to provide aid to support general-purpose imports. The alternative is to weaken the notion of a specific project or project component so that it includes a number of incidental and supplementary activities. Thus, one project should be made to include several supplementary posibilities or in other words many mini-projects.

Donor countries should also consider that country-tied aid frequently imposes an economic cost upon the recipient countries when a switch is not possible. In general, higher purchase costs can arise for various reasons, such as relative inefficiency or inflation, monopolistic selling or if the donor country's productive techniques are inappropriate to the recipient's economy. The tying of aid to specific sources can be quite harmful from the poor country's economic point of view (Myrdal 1970; Abott and MaCarthy 1981). Thus, it is necessary to work for a situation where this intertwining of aid policy is not considered crucial to the preservation of a sound balance of payments position in the lending country. Another measure is to call for a greater supply of international liquidity so that the lending countries will feel more confident in handling temporary balance of payments difficulties.

There is also another question about the strings attached to aid. If aid is linked with politics, the recipient country may be subject to political pressures from the donor country both before and after the aid flow (Hankinson and Blackburn 1987). In the minimization of political influences, multilateralism is important in aiding poor countries.

The formation of an aid consortium is an alternative in evaluating aid efforts and the future needs of a particular nation. This system can also be helpful for the recipient country as it needs to deal with only one body instead of several donor countries. It also permits a simultaneous arrangement which facilitates the efficient and effective allocation of aid for imports from different sources. The system is equally useful for the donor country as it makes it possible to avoid the duplication of efforts and pre-aid evaluations of the recipient country's overall economy.

Dissatisfaction with the current situation on both sides has created the possibility for new arrangements characterized by a greater congruence of interest and motivation on the part of donor and recipient. A new aid policy is also needed for efficient use of both foreign and domestic resources of the poor countries. The question of repayment and aid commitments for a longer period of time should also receive proper consideration. An efficient and effective aid plan also requires a guarantee of the donor country's assistance until the final implementation of any specific project.

The adjustment of the international economic system is also necessary in generating a sufficient increase in exports from the poor countries. Rich countries should consider diversifying and increasing the output of secondary products of local raw materials by their investment. Import from recipient countries should also be given priority by the donor countries, so that they will be able to repay their loans with the help of additional export earnings. The removal of tariff barriers, an end to restrictive business practices and monopolies, the setting up of a system of preferential tarifs to encourage the export of agricultural primary commodities (processed and semi-processed) should also receive attention and, this can be done by reforming the international trade mechanism.

Concluding remarks

A prominent feature of the last decade has been the increasing globalization of the world economy, particularly of production and finance. The spread of the deregulation of financial movements and electronic trading in developing countries has opened the way for massive transfer of funds and trading in securities. A network of relationship has been built up among private entities. Culturally also the world is increasingly inter-linked. The current intense concern about environmental degradation has also high lighted the close inter-relationships of nations and people.

But, only through the realization of the interdependence of developed and developing countries, and common interest in assisting each other can a process to maintain the harmony necessary for global stability and development be generated. It is not only a humanitarian question of values but also of interest. It is clear today that even in the long run, the economic and political interests of rich countries lie with the broad-based development of the poor countries. Eliminating poverty, minimizing inequality, and raising general standards of living of the people in the Third World are the basic frontier where rich and poor countries should fight together to ensure a better future.

REFERENCES

Abott George C. (1983): Massive transfers of resources, *Inter economics*, vol. 18, nr. 1, p. 18–26.

Abott Philip C. and McCarthy F. D. (1981): *The welfare costs of tied food aid*, International Institute of Applied Systems Analysis, Luxemburg.

Bhagwati Jagdish N. (1985): The tying of aid in Bhagwati Jagdish (ed.) *Dependence and interdependence*, MIT Press, Cambridge, Mass.

Bhagwati Jagdish N. (1972): *Amount and sharing of aid, in Assisting Countries: Problems of Debt, Burden-Sharing, Jobs and Trade*, Praeger, New York, p. 72–73.

Commonwealth Secretariat (1984): *The debt crisis and world economy*, Report of the Commonwealth Group of Experts, Marlborough House, London

De Long J. Bradford (1992): *The Marshall Plan: history's most successful structural adjustment program*, Discussion Papers of the Centre for Economic Policy Research, nr. 634, p. 1–48.

Ghos Pradip Kumar (1984): *Foreign aid and third world development*, Westport, Greenwood Press.

Hankinson A. and Blackburn R. (1987): Is government aid effective? *Management Accounting*, vol. 65, nr. 7.

Hayter T. and Watson C. (1985): *Aid rhetoric and reality*, Pluto Press, London

Highland Cory A. (1990): Aid for business in developing countries: who's doing what and what more should be done? *Finance and International Economy*, nr. 3, p. 138–153.

Maddison A. (1970): *Economic progress and policy in developing countries*, Allen and Unwin.

International Monetary Fund (1988): *World economic outlook*, International Monetary Fund, Washington, D.C.

Swell John and Stuart Tucker (1988): *Growth, exports, and jobs in a changing world economy*, Overseas Development Council.

Krueqer, Michalopoulos, Ruttan and Jay (1993): Aid and development, *Economic Development and Cultural Change*, vol. 41, nr. 4, p. 875–878.

Myrdal G. (1970): *The challenge of world poverty*, Penguin Press, London

Pietrobelli Carlo (1992): Inducing efficiency in the use of foreign aid: the case for incentive mechanisms, *The Journal of Development Studies*, vol. 29, nr. 1, p. 72–92.

Rodan Rosenstein (1961): International aid for underdeveloped countries, *Review of Economics and Statics*, vol. 43, nr. 2, Harvard.

Singer Hans W. and Javed A. Ansari (1988): *Rich and poor countries: consequences of international disorder*, Unwin Hyman, London.

Strand John (1992): Foreign aid, capital accumulation, and developing country resource extraction, *Journal of Development Economics*, vol. 38, nr. 1, p. 147–163.

Takagi Y. (1981): *Aid and debt problems in less developed countries*, Oxford Economic Papers, vol. 33, nr.2.

The Report of the South Commission (1990): *The challenge to the South*, Oxford University Press, New York.

Todaro Michael P. (1989): *Economic development in the Third World, Longman*, London.

Wood Robert E. (1986): *From Marshal Plan to debt crisis – foreign aid and development choices in the world economy*, University of Calif. Press, Berkeley, Calif.

World Bank (1988): *World debt tables 1987–88*, Washington, D.C., The World Bank.