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The Rise and Fall of Development Aid

Stephen Browne

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Stephen Browne
Chief, Regional Programme and Policy Division
Regional Bureau for Asia and the Pacific
United Nations Development Programme (UNDP)

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ABSTRACT

With the end of the cold war, the military prerogatives that motivate aid have clearly diminished in importance. However, other political and strategic considerations remain prominent in deciding the direction and content of development assistance. This paper re-examines the rationale for aid that accompanied its inception; revisits the development debate that accompanied its growth; and draws conclusions for aids' performance which may influence the future. The paper finds that the motivations for aid have changed quite radically, particularly in the 1990s, providing a new basis for future cooperation. The final section of the paper, describes briefly some of the areas which offer the most promising potential for an expansion of a development partnership. The role of the 'new' aid will be to facilitate and catalyse these areas of cooperation.

Foreign aid to developing countries has had no net impact on either the recipients' growth rate or the quality of their economic policies.

World Bank, 1997

Although arguments about quality and targets remain relevant, the world is moving to a new concept of what aid should be about...the new philosophy involves changing the relationship between donor and recipient governments from charity and dependency to interdependence and shared contractual obligation.

Report of the Commission on Global Governance, 1995

1. INTRODUCTION

In the 1990s, donors are giving urgent attention to the future of aid.[1] The US Congress has cut foreign assistance by almost half since 1990, and has considered ending aid altogether, or folding its aid agency into the State Department. To differing degrees, many other OECD donors have also trimmed their budgets and aligned aid more closely to foreign policy. Collectively, the OECD donors are devoting proportionately less of their GNP to aid than for 20 years. Some donors are now close to affirming their abandonment of aid targets established in the 1970s.

Why the concern?

As many commentators predicted, the end of the cold war removed one of the primary motivations for aid. But while military prerogatives have clearly diminished in importance, other political and strategic considerations remain prominent in deciding the direction and content of development assistance. This paper argues that, while there is a continuing strategic interest in aid, there has been a growing disillusionment with the performance of aid as a developmental resource.

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[1] The paper uses the terms 'development assistance' or 'aid' to refer to resources to meet the longer-term needs of development progress, as distinct from emergency or relief assistance designed to mitigate the consequences of short-term crises.

The argument is based on a review of development experience over half a century. During this period, nearly all countries have gained in prosperity. Global indices confirm that in the world as a whole, people are living longer, are healthier and more literate. Some former 'developing' countries have achieved standards of living similar to those of some 'developed' countries, when the broadest criteria of quality of life are taken into account. These indices are encouraging signs of progress for which many contributory factors can be adduced.

However, while during this period some US$1 trillion has been staked by the richer countries on the development process in the poorer ones, the contribution of aid to development progress has been harder to prove. In a world in which the population has grown by three billion, the numbers of those living in destitution have increased substantially. Some countries today are no nearer to overcoming their economic and human backwardness than at independence. Some countries, indeed, torn apart by internal strife, are scarcely countries. Yet these countries, and the still impoverished populations, have been the principal targets of development assistance.

It is legitimate to ask how much worse off the victims of underdevelopment would have been without aid. Unquestionably, the fruits of agricultural and health research, of technical training programmes and wider exposure to international experience – among other initiatives supported by aid – have had lasting benefits. But there are also uncomfortable answers to questions of whether aid may in some circumstances actually have worsened the plight of the poor and deprived in some countries.

These are some of the concerns prompting declining aid budgets in the US and in other traditional donor countries. But while this paper provides some of the arguments being used to question the utility of aid, it does not press for improvements in aid quality. Rather it goes beyond present aid patterns and questions the role of aid in the context of a global economic system which is heavily weighted against the interests of the weaker partners. In a globalizing world, individual countries can make palpable gains from changes of policies and institutions within their own gift. On the international plane, improvements in trade and finance conditions, and more equitable systems of global governance and interchange could bring

substantially larger benefits than more aid. And these gains would be on the basis of mature and mutually advantageous partnerships rather than paternalism.

This paper briefly examines the rationales for aid that accompanied its inception; revisits the development debate that accompanied the growth of aid; and draws conclusions for its performance which may influence the future. The paper finds that the motivations for aid have changed quite radically, particularly in the 1990s, providing a new basis for future cooperation. Some elements of these new partnerships are outlined in the latter part of the paper.

2. AID ORIGINS AND MOTIVATIONS

The beginnings of aid can be traced to three processes unfolding during the 1940s.[2] The first was the launching of the United Nations. Amidst the human, physical and economic devastation of warfare, a window opened briefly on the opportunity to safeguard peace through international collaboration among the Allies. The world's first aid agency (1943) was the United Nations Relief and Rehabilitation Administration (UNRRA), set up to address the human ravages of conflict in Europe. (UNRRA was the forerunner of UNHCR and UNICEF). By 1946, the new International Bank for Reconstruction and Development (World Bank) was extending its first loans in the same continent. Thus was the multilateral aid system born.

Secondly, even as the window began to swing closed with the Soviet Union's first Security Council vetoes in 1946, foreign bilateral aid began to be impelled by growing cold war rivalry. In 1948, General George Marshall's Plan began to funnel US$13 billion of assistance from America to Europe over four years – the equivalent of $90 billion today – with rapid and palpable results. But none of it reached beyond the Iron Curtain, although it was offered. Inevitably, therefore, Marshall aid became identified with the fortification of the 'free world' against the encroachment of communism. Thereafter, the theatre of rivalry spread to Asia, and the countries encircling the Soviet Union, leading to a new conflagration on the Korean peninsula in 1950. The 38th parallel is now the most tangible

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[2] S. Browne, *Foreign Aid in Practice* (London: Pinter Publishers and New York: University Press, 1990).

memorial of cold war aid, where many soldiers were sacrificed to ideology. The US military effort cost the equivalent of four Marshall Plans, and set a pattern – never subsequently shaken – for the meshing of America's aid with its military security.

Thirdly, the 1940s saw the beginning of the independence movement among the former colonies. Aside from vastly expanding the arena of ideological rivalry, independence encouraged new bilateral donors to build aid programmes as a continuation of their colonial obligations in the 1950s. The patterns varied. France's programme was more generous than Britain's, reflecting the contrasting nature of the immediate pre- and post-independence political relations. Even today, a significant portion of French aid continues to go to its protectorates (the DOM/TOM).

Thus, bilateral aid was first motivated by donor considerations of both a strategic and an historical nature. Compliance was also needed on the recipient side. We have come to take the provision of bilateral aid for granted, but it required a willingness of the newly-independent countries to sacrifice a part of their sovereignty for aid. For much of the 1950s, Sri Lanka was concerned to safeguard and strengthen the independence it had won in 1948, and was hesitant about accepting aid from any source. But its example was exceptional. Although the first newly-independent countries meeting at the Afro-Asian Conference of 1955 at Bandung, in Indonesia, proclaimed a philosophy of 'non-alignment', other considerations were soon to prevail over idealism. Non-alignment might have meant eschewing foreign assistance, or being willing to accept it from both ideological blocs. India was an early beneficiary of aid from both East and West. But perhaps the best historical examples of non-alignment were given by countries such as Egypt in the 1950s and Somalia in the 1970s which were able to summarily switch their aid allegiances from one bloc to the other.

A new multilateral aid phase can be said to have begun during the 1960s. At the beginning of the decade the principal donors agreed to set up the International Development Association under the control of the World Bank, and it was quickly established as financially the most significant source of concessional assistance. A pure grant facility on the same scale did not emerge from the UN despite protracted negotiations about a Special UN Fund for Economic Development (SUNFED). The tame concession was the Special Fund which had started in 1959 and which was

later added to the UN's Expanded Programme of Technical Assistance to become the UN Development Programme.

In parallel, however, several bilateral donors emerged which had none of the same military-strategic or post-colonial motivations for providing aid. Although their aid was an obvious adjunct to foreign policy, the programmes of Canada, Netherlands and the Nordic countries (the 'like-minded' donors) fundamentally arose from an altruistic and developmental vocation, linked to the desire to build political bridges to developing countries. Some analysts have called this 'real aid'.

There was a fifth motivation, which was commercial. It was characteristic of Japanese assistance, but has increasingly featured in all bilateral programmes through the tying of aid, and the growing practice of using trade credits in conjunction with aid to stimulate sales of domestic goods and services.

Type of aid	***Special characteristics***
Multilateral	Responds to developmental priorities
Bilateral-altruistic	Responds to perceived human needs
Bilateral-political/strategic	Underlines political influence
Bilateral-historical/cultural	Reinforces post-colonial alliances
Bilateral-commercial	Promotes exports, widens markets

Thus we may distinguish two principal forms of development assistance – non-strategic and strategic. On one hand, non-strategic aid was comprised of multilateral assistance and 'altruistic' bilateral aid, intended primarily to respond to the objective development needs of recipient countries. On the other hand, strategic (cold war), historical (post-colonial) and commercial aid was designed primarily to further the political, cultural and market influence of the donors.

These five types were not mutually distinctive. On the non-strategic side, all major donors have subscribed to multilateral aid, through the UN and the development banks, in addition to their bilateral programmes. Over the years, there has been a growth in 'multi-bi' assistance, through which donors have sought to give specific geographic or substantive direction to their multilateral contributions. Also, donor programmes with individual countries have often provided strategic (military) aid alongside assistance

of a political post-colonial nature. French aid in francophone Africa provides the best example.

The value of making these distinctions, however – which are differences of aid motivation – is to facilitate an understanding of the evolution of aid. Non-strategic aid has been influenced by analysis of the way aid is believed to contribute to development. Strategic aid has been influenced by geo-political developments.

The evolution of aid, and its motivations, is next traced through four 'aid ages'. These ages follow the fashions of development theory and help to explain the assumptions under which development assistance was provided. Through the ages, conclusions are drawn about the performance of aid, summarized in a subsequent section on 'lessons'. These lessons of experience – which raise concerns about the effectiveness of aid – are then used to help explain the evolution in aid motivation.

3. FOUR AID AGES

3.1 The first age: development through capital and growth (1950-1965)[3]

The post-war world was Keynesian. The British economist, a leading architect of the Bretton Woods institutions, was closely identified with theories that linked economic growth to capital investment. Growth theory was the essence of development studies – indeed the terms were essentially synonymous – and reconstruction under Marshall focused heavily on restoring dynamism to the economies in Europe. Capital was clearly perceived as the ingredient of reconstruction and progress.

At the heart of the theory was the 'incremental capital-output ratio (ICOR)', considered to be a stable function over time, which assumed that increases in capital investment led directly to output growth.[4] Several economists in

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[3] The notion of 'ages' has been partly inspired by Goran Hyden in a 1994 article: 'Shifting perspectives on development: implications for research' in Mette Mast *et al.*, *State and Locality* (Oslo: Norwegian Association for Development Research).

[4] See, for example, R. F. Harrod, 'An essay in dynamic theory', *Economic Journal* Vol. XLIX (London, 1939).

the 1950s[5] considered that the capital-orientated development experience of the industrial countries could be directly transplanted to the developing world. With the neo-classical theorists, the argument ran, the returns on capital would be higher in the developing world where capital was scarcer relative to other factors of production, particularly labour.

The influence of these western theories – built around the so-called Harrod-Domar model – could also be seen in the first national plans of the developing countries[6] and 'public investment plans' still form the centre-pieces of some World Bank Consultative Group (aid mobilization) meetings. The role of aid was to bridge the domestic resource gaps of the developing countries by raising the rates of productive investment. A seminal work from this era was one of the fullest expositions to that date of a development model.[7] In the stages of economic growth, the first condition for 'take-off' was a rise in the investment rate, which could be achieved through an exogenous injection of capital.

A further refinement of Rostow was developed in 1966 by Chenery and Strout, outlining the role for aid more comprehensively.[8] It was another stages-of-development approach, also known as the two-gap model: during the first two stages of economic development, aid was required to bridge the difference between capital investment needs and domestic savings (the internal gap), and to finance the necessary increase in imports (the external gap).

Much of the essence of these theories is lost in paraphrase. There were other critical aspects of these and other theories, but they were given insufficient attention by the development school during this first age of aid. Rostow's third condition had been the emergence of a political, social and institutional framework that facilitated ongoing expansion – a

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[5] S. Kuznets, 'Underdeveloped countries and the pre-industrial phase in the advanced countries' in Proceedings of the World Population Conference, (New York: United Nations, 1954); W. W. Rostow, 'The take-off into self-sustained growth', *Economic Journal* (London, 1956).

[6] L. de Silva, *Development Aid: A Guide to Facts an Issues* (Geneva, UN-NGLS and Third World Forum).

[7] W.W. Rostow, *The Stages of Economic Growth* (Cambridge: Cambridge University Press, 1960).

[8] H. Chenery and A. Strout, 'Foreign assistance and economic development', *American Economic Review* Vol. 56 (1966).

fundamental concept of sustainability that underlies today's fashionable 'governance' debate. Chenery and Strout also laid stress on the importance of technical assistance and the development of skills as an essential accompaniment to capital and as fundamental to absorptive capacity. We shall return to these points below.

Almost since its inception, the United Nations had also been drawing attention to the importance of directing aid to supporting 'social productivity' in the interests of global welfare.[9] During the first age, however, donor attention was mainly fixed on the safer prerogative of capital investment. It stemmed from a basic misgiving – which is now returning – about the practice of giving away, rather than lending, funds to the developing world. Technical assistance was a gift with uncertain returns, unless it came embodied in the exportable goods and services of bilateral donors. Multilateral technical assistance was the least trust-worthy of all, especially through the UN where the industrial countries soon lost their voting majority as the world body gained new members.

Aid from the Soviet bloc carried many of the same prerogatives. Premier Khruschev proclaimed in 1956 that developing countries had no need 'to go begging to their former oppressors' for aid. But it came in similar wrappers. Socialist principles, handed down from the commanding heights of heavy industry, had served Soviet economic advance well. They also emphasized capital investment, as manifested in the vast Soviet industrial and infrastructure projects that began to appear in the South.

The first age of aid was thus dominated by development models which perceived development paths as unilinear, exalting capital investment as the engine of economic growth. It was a paradigm of modernization, of aping the North. It was also a model in which the State – within the new sovereign countries – was expected to play a leading role as planner and investor. Thinking during this age encouraged the growth of capital transfers through concessional loans and grants to the governments and public sectors of developing countries.

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[9] One of the chief exponents was Hans Singer of the Institute of Development Studies, Sussex, and formerly one of the first economists to work in the UN secretariat, New York.

3.2 The second age: interdependence and basic needs (1965-1980)

During the second age – from the mid-1960s to the mid-1970s – misgivings were already arising over the supposedly beneficial connection between aid and savings,[10] and even the pro-aid Pearson Report[11] described as 'very weak' the correlation between aid and growth.[12] The development debate became more complex, and more ideological. It was conducted on at least two planes: the plane of international economics, but now also at the micro-level of the individual.

International economic arguments turned on the concept of dependency. In its benign version, the argument contended that developing countries stood to benefit from the increasing interdependence of the North and South, particularly with respect to trade. The benefits of openness in the economies of some East Asian could already be seen to redound in rapidly growing exports, as well as inflows of direct investment. Such evidence provided fertile ground for the 'trade-rather-than-aid' school, according to which developing countries could arguably earn more than they could be provided through concessional transfers.

But there was another, quite different, view which saw the benefits of interdependence flowing mainly in one direction, towards the rich countries. This view looked more closely at the quality of trade and investment, and saw other disadvantages of interdependence.[13] Many developing countries have traditionally depended on the export of primary

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[10] For example, K. Griffin, *Foreign, aid, domestic savings and economic development*, Bulletin of the Oxford University Institute of Economics and Statistics Volume 32 (May 1970).

[11] L. B. Pearson *et al.*, *Partners in Development: Report of the Commission on International Development* (London: Pal Mall 1969).

[12] A more rigorous study from the 1980s concludes: 'The main empirical result of this chapter ["Aid as Instrument of Development"] is a negative one, namely that there appears to be no statistically significant correlation in <u>any</u> post-war period, either positive or negative, between inflows of development aid and the growth rate of GNP in developing countries when other causal influences on growth are taken into account.' Paul Mosely, *Overseas Aid: Its Defence and Reform* (London: Wheatsheaf Books, 1987), 139.

[13] From the ideological left, integrated global markets were a mirror of the exploitative patterns within capitalist economies. One of the foremost exponents of this view was Samir Amin in *L'Accumulation a l'Echelle Mondiale* (Paris, 1970) who spoke of the developing countries as the economic periphery around a centre of metropolitan powers.

products, and the terms of trade have moved against them for most of the post-war period. While the expansion of industrial markets could lead to growth in demand for developing country exports, increasing protectionism – especially during these years, before the benefits of successive global trade negotiations began to bear fruit – succeeded in limiting market access.[14] The benefits of foreign investment could be mitigated by lop-sided terms in the initial negotiations, and by multinational corporations extracting additional advantages through devices such as transfer pricing.

In hindsight, the most serious weakness of the system of international governance that came out of the post-war period was the absence of a regulatory trade organization and the reliance on financial mechanisms. Economists were divided on the best way in which to protect the trade interests of the developing countries, a dichotomy that depended partly on predictions about the future course of the terms of trade. This was the basis of disagreement about the benefits of interdependence. Financial regulation through the Bretton Woods institutions was predicted by some to be adequate to compensate for time-limited imbalances among the weaker partners. But neither the export production promoting loans of the World Bank, nor the temporary borrowing mechanisms of the IMF, could possibly have compensated for the chronic payments crises of the countries suffering from long-term declines in real commodity prices. Worse still, developing countries quickly accumulated debts to the Bretton Woods institutions which could neither be forgiven nor rescheduled. And since both bodies were governed through a weighted voting system, their major clients could do little to change the operating principles.

During the early 1970s, the Organization of Petroleum Exporting Countries (mainly the Arab States and Iran) staged its own spectacular demonstration of trading dis-order when it used its power as a cartel to raise oil prices substantially. OPEC's success gave impetus to the demands of developing countries in the UN for a 'new international economic order', unpopular with the industrialized countries at the time, but incorporating

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[14] UNDP estimated in its 1994 Human Development Report that the cost to developing countries of protectionism in the textile and clothing markets was $50 billion, and in agrarian commodities, $22 billion. An earlier study by the OECD estimated that a 30% reduction of OECD border measures would result in $90 billion of benefits for developing countries. (Paris: OECD, Development Cooperation Report, 1992). These figures are higher than the OECD's estimates of annual aid flows.

several goals which are even more urgent two decades later. However, OPEC also highlighted the ambiguity of southern solidarity since the major costs of the oil price increases were borne by the developing countries, (and the major gains by the commercial banks of the North).

But there was another consequence of OPEC for the development assistance: the sudden emergence of new donors in the Middle-East. For the decade of the 1970s as a whole, OPEC aid was equivalent to one quarter of the total from the OECD countries, although it has diminished drastically since.

At one level, the second age was characterized both by the laissez-faire school of economic openness, and the radical detractors arguing for the de-linking of developing countries from the international economy. Both schools were associated with anti-aid movements. The marketeers contended that aid was superfluous in a global economy increasingly dominated by private capital. The de-linkers argued for more collective self-sufficiency among developing countries, among which the OPEC countries were still counted.

Politically, however, aid retained its respectability, gaining wider official acceptance as a legitimate form of compensation for the disadvantaged. Aid came to be associated with quantitative targets,[15] somewhat analogous to a global tax scheme. For two principal reasons, however, targeting has not served aid well. First, these targets have remained stubbornly out of reach of nearly all the major donors, and thus seemingly irrelevant. Second, targets have implied that aid had become an automatic requirement based on arbitrarily determined supply levels, rather than a response to carefully defined needs. By helping to substitute declamation for debate, targeting may have even hastened the eventual demise of non-strategic aid.

Nonetheless, the nature of development processes themselves were receiving much greater attention during this phase, and this analysis was eventually to have an important influence on aid programmes and on future global cooperation. Two issues first became more prominent during the 1970s: the environment and population.

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[15] The Pearson Commission had advocated that each developed country should raise its expenditure on official development assistance to 0.7% of GNP, a target subsequently endorsed by the UN and adopted by the OECD DAC.

In 1972, the UN sponsored a conference on the 'human environment' which examined the quality of human life and the natural resources that support it. After the conference, the international community rapidly lost interest in environmental concerns for at least a decade and a half, not because the issues were unimportant, but largely because they were invisible in the North and seemed to threaten to circumscribe unfettered growth in the South. When in the 1980s, the signs of global warming began to appear, donors began to understand the global dimensions of the phenomena and environmental issues rose to the top of the development agenda.

In the 1970s, the focus on human indicators – as opposed to merely economic ones – was sustained. For the first time a consensus seemed to be emerging about the fundamental differences in southern development parameters. Populations were very large and growing rapidly. So was poverty, for which western modernization models based on technology seemed unsuited. Small was suddenly beautiful,[16] and nothing was more important that the basic needs[17] of the majority. The orthodox economic reaction was to advocate 'redistribution with growth',[18] and begin to recognize that even in the more macro-economically dynamic developing countries, but especially in the more slothful ones, intractable poverty prevailed. As with the environment, donor interest stemmed not just from altruistic concern, but also from more selfish preoccupations with the demographic explosion in the South and the pressures for migration. Aid for population control methods in developing countries – in spite of their highly disputable connection with development progress – has always flowed generously.

3.3 The third age: structural adjustment and the rise of the NGO (the 1980s)

In the third age, the dependency chickens were returning to roost. The surplus global savings balance of the 1970s – accumulated in part by the huge increase in unspendable export earnings by OPEC – had stimulated substantial lending to developing countries. By the turn of the new decade,

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16 E. Schumacher, *Small is Beautiful: a Study of Economics as if People Mattered* (London: Sphere Books, 1974).

17 International Labour Office, *Employment Growth and Basic Needs: a One World Problem*, (New York: Praeger, 1977).

18 H. Chenery *et al.*, *Redistribution with Growth* (Oxford: OUP, 1974).

the unfamiliar phenomenon of 'stagflation' was assailing the developed countries and the costs of borrowing had mounted rapidly. The South was heavily in debt. After two decades of aid, most of the developing countries were much further away than ever from closing the two gaps of the Chenery-Strout model. The banking system accommodated partially. The most exposed commercial banks absorbed some of the losses through bad debt provisions, and limited grant aid was diverted to provide for official debt restructuring. With these measures, and with a bout of enforced fiscal repression in the South, the crisis gradually abated. The only major symptom of breakdown had been the default of Mexico (in 1982).

Ironically, the Bretton Woods financial mechanism, originally established to regulate global imbalances, took none of the hits, but responded with more short-term lending. By mid-decade the flow of funds had turned around so that the developing countries as a whole became the net creditors of the World Bank and IMF. These costs of financial dependence were attributed by World Bank economists at the time, not only to the disadvantages of interdependence, but also to policy failure on the part of the borrowers.[19] To the uncertainties of trade, and the burden of debt in the developing world, had been added the necessity for comprehensive structural adjustment, essentially a set of policy measures designed to close the internal and external resource gaps.

With the World Bank's first 'structural adjustment loan' in 1980, a new aid phase of macro-economic governance had begun, in which the choices for the developing countries – and hence a large measure of their economic sovereignty – were further circumscribed. From here on, there would be a much greater degree of consensus among the donors about the conditions for lending as well as aid provision. Donors were more determined to elicit conditions for the type of assistance provided, in addition to the conditions imposed by the tying of aid to home exports.[20] This age, therefore, added a new strategic spin to aid motivation.

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[19] For example, S. Please, 'The World Bank: lending for structural adjustment' in R. Feinberg and V. Kalab, *Adjustment Crisis in the Third World* (Washington, Overseas Development Council, 1984): ' ... unpropitious external circumstances were intensified further by the widespread failure of developing countries to take effective steps to assure their ability to meet the debt-service obligations on the large flows of funds obtained from commercial banks during the second half of the 1970s.'

[20] It has been estimated that, on an average, 75% of the value of bilateral technical assistance projects returns to donor countries: 21% to the originating donor as

The beginning of the decade was also the time when consensus about aid within donor countries broke apart. In 1980, Willy Brandt published the first report of his Commission. The 'programme of survival' urged for a new compact between North and South, and Marshall-style 'massive transfers' which would reap their own dividends in global economic stimulus. Pearson had made the same case a decade earlier, but less convincingly. The public was mobilized to press governments for action on what would have been a revisited new world economic order. Momentum developed amongst pro-aid lobbies in western countries in the months before the much-heralded development summit of 22 world leaders meeting in Cancun, Mexico, in 1981.

But the summit was a disappointment for the new aid lobbyists. Its timing during the sharp economic down-turn in the world economy was scarcely propitious. What helped to doom it, however, were the conservative positions of the new administrations in the USA and UK, which displayed a new zeal for market mechanisms, an unwavering belief in the power of private capital, and hostility to the notion of government-sponsored economic stimuli. In some western policy-makers' books, neo-Keynesianism no longer applied. The notion of new massive transfers was still-born.

While there was no substantial increase in aid flows, official development assistance remained quite buoyant during the 1980s. One stimulant was the channelling of more resources through non-governmental organizations in both donor and recipient countries. The Brandt momentum had not been wholly dissipated. More importantly, the drama of the famines that recurred in 1983 in eastern Africa was now being disseminated through the global media. The western public responded generously through the charitable organizations which seemed better able and more inclined than government agencies to meet the succession of emergencies.

For our aid story, however, evidence was accumulating that more aid on any scale – while it helped to temporarily alleviate the plight of the victims of crisis – was not likely to engender significant and sustainable advantages for the neediest in the developing world. The African famines,

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administration costs, and the remaining 54% to the originating donor, or other donor countries. The more tied is the aid, the larger the proportion of this 54% (and often all of it) returns to the originating donor. (Browne, op.cit.).

real and potential, were occurring in some of the most generously aided countries and were in all cases attributable to subtle factors of human origin which aid was seemingly unable to influence.

The 1980s have been described as a defining decade: serious economic setbacks (and negative growth) in Latin America; stagnation, famine and continuing human misery in Africa. There were also harsh, if belated, reappraisals of aid programmes. 'Does aid work?' asked one exhaustive study in 1986. 'Yes, but only partially' was the response.[21] As the decade wore on, the cherished adjustment process was in serious doubt. Macro-economic stabilization, where it was not blown off course by emergencies, was unrealistic in its prescription and politically clumsy. As a result of dismal evaluations, donor governments no longer trusted themselves. But they trusted client governments even less.

3.4 The fourth age: the end of the cold war and the importance of institutions (the 1990s)

The fourth age has seen Latin America recovering from its 'lost decade' characterized by a prolonged crisis of confidence, by people in their governments and by the international community in the continent as a whole. Recent years have provided a spectacular – and somewhat unique – example of the benefits of democracy bringing more social cohesion, responsible financial management and more investment.[22] In some important respects, the continent demonstrates how beneficial can be an absence of aid. Ultimately, chronic indebtedness had to be overcome through greater domestic policy discipline, protectionism gave way to substantial trade liberalization, and state assets were privatized.[23] These were decisions that had to be taken entirely from within. Perhaps the most important role of the international community was to stand firm and make clear where the responsibility lay.

The major milestone in the fourth age – the current one – has been the end of the cold war and the disintegration of the last modern empire. The break

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[21] R. Cassen *et al.*, *Does Aid Work*? (Oxford: OUP, 1986).

[22] Between the mid-1980s and the mid-1990s, the proportion of democratic countries rose from 40 to 60%, according to Freedom House.

[23] Although the Mexico crisis of 1995 prompted a massive financial bail-out led by the USA and the IMF, it was quickly overcome as confidence was restored to the economy as a result of tighter domestic policies.

has not been a clean one. The aftershocks of the disintegration in Europe and Central Asia are likely to persist for as long as there are ex-communists in positions of influence. In Cuba, and to a more limited degree in North Korea, a 'Cool War' still prevails. But globally, the march to market is proceeding. While aid from the North has lost its military motivation, however, the rising importance of political and commercial factors has nevertheless made it more – rather than less – strategic and less developmental.[24]

For the story of aid, the significance of these transitions has not only been the end of the bipolar struggle for global influence. It was also the inability by the donor community to heed the lessons of one of the more notable achievements of the post-war era. In many senses, the fall of the Soviet empire has confronted western Europe with the same challenge in Europe as the USA faced in the aftermath of the Second World War: collapsed economies and infrastructure, pressing short-term human needs and a pervasive sense of pessimism (yet well-educated manpower resources) throughout the eastern part of the continent. But where the USA responded in the 1940s with generous short-term financial assistance and preferential access to its markets, the countries of the European Union (and the USA) have sought to provide piecemeal packages of aid to the countries of the former Soviet Union. With the exception of some early and limited commodity aid, they have lined up with the IMF to extend limited and long-delayed financial assistance and selective technical assistance closely tied to home expertise. But much of this assistance is negated by the raising of trade barriers to protect domestic markets.

Marshall-style injections of capital would not have been sufficient to restore the health of the post-Soviet economies. In any case it is private capital which these countries should be seeking, with official capital acting as guarantor. But market access would have been, and is, critical to revival. Also, the technical assistance programmes that are the basis of western aid manifest a poor understanding of the special circumstances of the newly-independent countries. The triple transition[25] which the countries of the

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[24] See, for example, Roger Riddell, *Aid in the 21st Century*. UNDP Office of Development Studies, Discussion Paper no. 6 (New York: UNDP, 1996).

[25] In some countries in the Soviet sphere, the bankruptcy of central planning and the transition to market economics played a role in the changes of regime. Equally strong, however, were the forces of democracy (in Eastern Europe), and the yearnings for

former Soviet Union are experiencing is more far-reaching and more abrupt than any societal transformation seen in recent history. It also abrogates the more natural process whereby economic reform has preceded political change, sometimes by several decades. Yet, donors have set out to pressure these countries to adopt economic policies and models which are often more radically market-orientated than their own. The drive to privatize industrial enterprises, utilities and banks is trying to move some of the newly-independent countries further and faster than countries like Italy and France. Similarly, the advocated schedules for reducing or even eliminating housing subsidies – which prevail in every country in the world – have been so rapid that they risk causing very serious hardship, particularly among the elderly.

These attempts to graft pure market practices on to reluctant hosts will fail as long as the institutional mechanisms are not in place. Following two or three generations of central planning and anti-market propaganda, these institutions will take a while to nurture. In their enthusiasm to help compliant reformers in these countries to comprehensively overturn the old order, western partners have failed signally to understand how revolutionary these changes appear to three generations who lived under socialism. An example is given by the attempts to encourage the summary privatization of land-holdings and destroy the social capital inherent in collective ownership. Probably the most useful forms of aid would be the teaching of market economics and exposure to model legal and organizational frameworks.[26] Stable institutions are needed for a new entrepreneurial culture to flourish and for a measure of business confidence to be restored.[27]

But in spite of western protectionism and much bad advice, most of the post-Soviet countries will come through their transitions in due time and find new paths of progress. The same cannot be said for the countries in continuing paralysis which continue to feature all too prominently in this

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independence (the Baltic States, Ukraine, Armenia, Georgia). These transformations of statehood, democracy and market reform have been described as the 'triple transition'.

[26] S. Browne and C. Pflaumer, 'Aiding the triple transition in Ukraine', *International Journal of Technical Cooperation* Vol. 2 no. 1 (London: Frank Cass, 1996).

[27] It has been estimated that the Russian economy has lost some $130 billion in capital flight as a result of low business confidence. This amount is many times higher than Russia has been able to attract in official capital to bridge its yawning investment-savings gap.

fourth age. If there is still a strong case to be made for aid, it is not for development assistance, but for relief and emergencies to help cope with the human costs of man-made crisis, particularly in sub-Saharan Africa. Between 1990 and 1995, emergency and refugee assistance grew from $1 billion to $3 billion and the costs of peace-keeping activities through the UN, from $500,000 to almost $3.5 billion. Together these figures are equal to well over one tenth of official aid.

Analysts spend considerable time these days debating the 'continuum', trying to determine where development assistance ends and relief begins. Partly it is a matter of definition, partly of judging sequences. A much more important debate needs to deal with the question of why paralysis prevails in so many countries which had earlier been the recipients of generous development aid: Angola, Burundi, Rwanda, Somalia, Sudan, Zaire, and others. Was the aid misdirected? Were the donors who had a major financial stake in these countries, oblivious of the danger signals?

Having lived for two years in one of these countries (Somalia) at a time when it enjoyed the highest per capita western aid allocation in Africa, the author can supply some of the answers from his own experience. Western development aid showed the same indifference to the importance of strengthening institutions as it has more recently manifested in eastern Europe. Projects did little to enhance the sustainability of development processes. Aid was motivated by strategic considerations, aimed at keeping governments friendly, and by commercial opportunities for home industry and services. Multilateral assistance led short-term relief efforts when emergencies broke out, but aid programmes concentrated very little on – neither were they sufficiently cognisant of – the underlying ethnic tensions which threatened social cohesion, the debilitating consequences of corruption, the neglect of social investment, and the complexity of other institutional factors which would have helped to safeguard and fructify the aid already provided.

There is, on the other hand, a sound basis for arguing that some of the aid provided actually helped to precipitate crisis. The linking of bilateral and military assistance put armaments into the hands of regimes which, bent on self-preservation more than development progress, used them against

compatriots.[28] The considerable flow of aid through government channels also constituted one of the prizes of office to be defended.

The institutional prerogative, already anticipated by Rostow and others in the 1950s – but ignored at the time – has now been embellished in the post-Soviet era with the democratic ideal and finds contemporary expression in this last aid age through 'good governance', a term coined in 1990.

4. LESSONS OF THE AID AGES

A review of the four ages has important lessons to impart about the efficacity of aid.

Lesson 1: There is no conclusive evidence that official capital or food aid have contributed to gap-filling on a sustainable basis. We have already noted the findings of earlier research about the weak correlation between aid, savings and growth. Since the circumstances of each developing country have been very different, and the amounts of investible funds within aid programmes have varied enormously from recipient country to recipient country, it is necessary to look at particular cases. In some countries, the inflows have been large relative to GNP, in others quite small. In some, high inflows have gone to countries with consistently high savings rates and higher investment rates (Malaysia, Korea). These countries – showing a high correlation of aid to investment – have needed capital aid least, but have put it to the most productive use. High investible inflows of aid funds have also gone to countries with low domestic savings rates, in which investment and savings have remained at chronically depressed levels. These were the countries – showing a low correlation of aid to investment – which needed capital aid most, but have used it least well.

Although there are many variants of these relationships, it is tempting to concur with some critics that capital aid either goes to countries that don't need it or those that can't use it. At worst, the 'displacement theorists'

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[28] Data released by the Pentagon in early 1997 reveal that Liberia, Somalia, Sudan and Zaire – all countries torn apart by civil wars – together owe the USA $430 million in arms sales loans.

conclude that in the neediest countries aid had been diverted to other than productive uses and has removed the incentive for recipient governments to improve fiscal and monetary discipline and raise public and private savings performance. Experience thus infers that aid is bound to be unproductive if it is not accompanied by sound domestic economic policies, but that where they are sound, and where governments are desirous of attracting outside finance, aid will readily flow from private sources to finance productive activities and infrastructure. The only role for capital aid is one of temporary pump-priming and even then, official project aid should only be applied in circumstances which guarantee adequate returns (taking full account of commercial and environmental criteria). Programme aid – such as balance of payments support – should also be seen as a strictly temporary means of buying time until a country can diminish its external resource gap.

Similar conclusions apply to food aid, which comprises about one-tenth of the assistance given by some donors. As a development resource, food aid (which is often monetized through sale on local markets) is a legitimate form of gap-filling, but only in the short-term, or where it contributes directly to an internally-generated dynamic process of development, for example by helping to foster sustainable increases in domestic production. Unfortunately food aid – on which some countries have continued to depend for decades – does not always conform to these criteria.[29]

Lesson 2: The system of global economic governance has failed to mitigate the adverse conditions of the global economy for many developing countries. While OPEC demonstrated the spectacular benefits of sharp improvements in terms of trade, a steady deterioration in the terms faced by many developing countries can compound their disadvantages and indefinitely postpone their ability to close the external resources gap: their balance of trade stays negative and their recourse to borrowing leads to mounting debts. Attempts by the UN (notably UNCTAD) and the Economic Union to go against market forces and build commodity agreements, or provide compensatory funds, have been expensive and unsustainable, since they only address one side of the transaction (supply) in the face of declining or weak demand. The most effective combination of measures which developing countries could take include selective trade

29 '... as long as food aid is badly administered by the donors and/or the recipients no real benefit can be expected'. Kunibert Raffer and Hans Singer, *The Foreign Aid Business*, (Cheltenham: Edward Elgar, 1996), 87.

protection, a switch of resources to tradable goods, complemented by open markets among the rich countries. The first of these measures has always been strongly opposed by Bretton Woods policy conditionality, while the last condition – closed and restricted markets in developed countries – has only begun to emerge after eight rounds of global trade negotiations. In the meantime, access to capital markets has been on terms that are hard, either in financial cost or policy conditions. UNDP has calculated that the costs to the developing countries of unequal access to global capital and commodities markets are nearly ten times larger than the value of net aid transfers,[30] prompting the conclusion that the need for aid would diminish if the richer countries concentrated harder on making the rules of the game fairer.

Lesson 3: There are many essential institutional and contextual conditions necessary for development to proceed on a sustainable basis, which have little to do with economics and which have been left largely untouched by aid. For most of its life, aid has been the preserve of economists, who have been ardent advocates of western-inspired economic policies and conditions that make markets work better, but poor proponents of the institutions needed to underpin beneficial change. Technical cooperation programmes have for the most part also performed inadequately in this respect.[31] Training and human resource development – the 'third gap' to be addressed by the development process – have been a target of technical cooperation, along with vaguely conceived objectives of 'capacity building'. In practice, TC has, to a considerable degree, focused on creating or strengthening organizations in the public domain, many of them providing support specifically to projects inspired and financed by donors. At a broader level, TC has sought to bring about reform of the public sector as a whole, which has mainly meant shrinking the civil service.

These efforts have led to incremental change on a piece-meal basis. But they have tended to leave out of account the strengthening of institutions: the sanctioned norms and rules of conduct which guide individual and

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30 United Nations Development Programme, *Human Development Report 1992* (New York: OUP, 1992).

31 'Almost everybody acknowledges the ineffectiveness of technical cooperation in what is or should be its major objective: achievement of greater self-reliance in the recipient countries by building institutions and strengthening local capacities...' UNDP, *Rethinking Technical Cooperation: Reforms for Capacity Building in Africa* (New York, 1993).

collective behaviour. Equitable and sustainable progress will remain elusive if there are not adequate standards of honesty and transparency in bureaucracy, if the rule of law does not prevail, if there are no clear legal frameworks that safeguard property rights, or if people are barred from influencing the decisions of leaders. The now fashionable emphasis on 'good governance' in aid programmes may raise awareness of the importance of the institutional context of development. But there are dangers that the term is either interpreted broadly and subjectively by donors to mean 'a regime/administration/organization we can do business with' or narrowly and objectively through the prism of western democratic ideals. The UN's current enthusiasm for supporting elections in the new democracies, for example, should not obfuscate the need to create other conditions necessary to sustain more participation and openness. But this last consideration begs the much more fundamental question of the extent to which donors – multilateral or bilateral – can actually have any permanent influence on institutions in developing countries.

Lesson 4: Development aid has perpetuated a two-tier (or four-tier) global hierarchy which inhibits the widening of international cooperation.. Development experience has demonstrated the artificiality of a world divided into 'donors' and 'recipients': even first (western industrialized), second (eastern industrialized), third (middle-income developing) and fourth (poorest developing) worlds. Yet an aid culture has helped to foster – in the course of half a century – a notion of two 'worlds' distinguished only by whether they were givers or receivers of aid. The artificiality of this distinction has been perpetuated by the existence of clubs. On one side, the original recipients of Marshall Aid re-formed themselves into the Organization of Economic Cooperation for Development (OECD) and invited Japan, Australia, New Zealand and others to become the rich club, within which most of the membership (21 countries) belongs to the Development Assistance Committee of donors. On the other side, there has been the 'Group of 77' and the Non-Aligned Movement. There has been very little crossing of the divide, although Mexico (1995) and South Korea (1996) have recently become members of OECD (but not yet the DAC).

On both sides, the economies are vastly different in size, endowment, level of income, openness, market-orientation. Even in terms of income per head, the distinction is artificial, since there are many members of the latter club (Singapore, Kuwait, Israel, Brunei among others) which are 'richer' in these terms than members of the former. There are also vast demographic,

cultural, societal, political and multiple other differences which make each country a special case.

This paper has hitherto made no apologies for observing the same dichotomous distinction in its labelling of countries as donors and recipients, and developed and developing, because it is a distinction mainly defined by aid. As we will argue, however, the distinction is becoming increasingly anachronistic and inimical to international relations. It vests membership of one or the other 'clubs' with a spurious degree of sameness in respect to outlooks and aspirations on international cooperation. And these affiliations tend to instil into international relations *a priori* notions of superior/inferior, stronger/weaker, dominant/subordinate, independent/dependent which are increasingly meaningless in a world in which official resource flows are being supplemented and supplanted by other, more equitable, bases of cooperation.

5. CHANGING MOTIVATIONS, DECLINING AID

A fifth lesson of the aid ages has been a steady convergence in the five principal motivations for aid: multilateral, altruistic, military-strategic, politico-strategic and commercial.

The end of the cold war removed the rationale for aid based on military-strategic spheres of influence, although it did not remove the rationale for military sales aid (through export credits) for which the middle-income countries of Asia and Latin America are still providing a buoyant market for western arms exporters. Russia and other countries of the former Soviet sphere are also cashing in on continuing militarization in some emerging markets.

Through the aid ages, the distinctions among the other motivations for development aid have become blurred. Emergency assistance from the donors has continued to be driven by a spirit of selfless altruism (even where the causes of crisis were the direct result of inhumanity). But development aid has become increasingly allied with other, more self-interested considerations. Multilateral development aid, which in its purest expression had subsumed national interest into wider developmental objectives, has been diluted by the rising influence of individual donors

within the different UN agencies and the development banks. The 'like-minded' bilateral donors have also added stronger political criteria to their aid choices, exemplified by the fact that all four Nordic countries have in recent years more closely integrated their aid agencies with their foreign ministries. Most bilateral donors, beginning in the 1980s, have also aligned their aid with commercial concerns.

This general convergence has been prompted by two main donor perceptions. In the first place, there has been a growing perception that aid often does not *of itself* make a critical difference to development performance, for all the reasons cited in the foregoing discussion. Aid does not play an effective gap-filling role, but can catalyse processes. Development assistance (as opposed to emergency aid) should, therefore, be steered increasingly into environments which are 'friendly' and sustainable.

Secondly, donors – from their own experience as well as from their perceptions of the developing world – have determined that markets are the major sources of dynamism in development, as demonstrated by the wave of liberalization that has overtaken many developing countries in the present decade. Publicly-administered resources have a diminished role. Increasingly the state is called upon to facilitate the freer working of markets rather then trying to substitute for them. Aid is seen, not as an indispensable resource, but as an adjunct to this facilitation process.

For these reasons, the fourth age has seen a sudden slackening of the donor aid effort. According to the data of the OECD Development Assistance Committee (DAC),[32] levels of development assistance from 21 donor countries in 1996 were the equivalent of US$51.5 billion (in 1994 prices). In real terms, this figure is lower than ten years earlier following a 9% fall in 1995 and a further fall of 4% in 1996 (see Figure 1). In that year – the latest for which full figures are available – the proportion of DAC country GNP given as aid fell to 0.25%, the lowest it has ever been, making the original target of 0.7% even more irrelevant. The signs are of continuing stagnation in 1997. The decline in aid has not been true of all donors. If the figures are disaggregated, they reveal that the decline in aid in the 1990s is

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32 Organization for Economic Cooperation and Development, *Development Cooperation: 1996 Report* (Paris: Development Assistance Committee, 1997).

mainly attributable to falls in disbursements by two large donors, USA[33] and Italy, particularly since 1988-89, but that these falls are partially compensated by increases – albeit uneven – in Japan since 1987. In 1996, however, Japanese aid recorded a real decline of 25%.

In 1996, however, the overall decline in development assistance to traditional recipient countries is, moreover, understated by the OECD data. Since 1990, the Soviet bloc countries almost ceased their own aid programmes and became recipients of aid and other less-concessional forms of assistance. The traditional recipients have thus 'lost' in two senses, amounting to reduced annual amounts of $10-12 billion, or 20-25% of total aid flows.

Notwithstanding the exhortations of OECD DAC and the major multilateral aid agencies, the peace dividend that might have been supposed to follow the steady reductions in military spending did not materialize – or at least did not result in a switching of national budgets in favour of aid. The major reasons for declining aid budgets by many of the donors have been related to a tightening of fiscal constraints. In the case of the USA – which proportionately enjoys one of the smallest budget deficits among OECD countries – balanced budgeting has become a strong political issue. In the case of the countries of the European Union, budgetary stringency is related to the need to conform to the terms of the Maastricht treaty (maximum budget deficit of 3% of GNP) prior to unifying their currencies in 1999.

But the budget strait-jacket is obviously not the full explanation. Aid is a rather small component of national budgets, which could be protected even when spending is being constrained. The fact is that the constituency for aid is weakening as a result of the perceptions described above.

There are also symptoms that aid is already more than adequate. Related to Lesson 1 above, the recognition is gaining that the role of official aid as a source of productive capital – a role increasingly in dispute – has been supplanted in a growing number of emerging economies by private capital, and in particular by foreign direct investment. Figure 3 shows the rapid

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[33] It could be argued that the USA is even beginning to put aid into reverse. More and more frequently, countries are being subjected to economic sanctions, intended to hinder them economically. Since 1993 sanctions have either been imposed or threatened by legislation no fewer than 60 times, targeting 35 countries.

growth in private capital flowing to developing countries since 1990. In five years total private capital from the OECD countries had risen from virtual parity with aid to a figure which is nearly three times the size. In 1996, assuming that OECD aid has remained stagnant, the ratio is more than four times.

Development agencies are quick to point out that these private capital flows are very unevenly distributed. Among the developing countries, the ten largest hosts received two thirds of foreign direct investment and the smallest 100 recipients received only 1%.[34] However, the number and importance of recipient countries is growing and more could be done to accelerate the process.[35] In India – the country with the largest numbers of those in absolute poverty – a programme of domestic economic reform encouraged a tripling of foreign direct investment inflows in 1995 alone. There are other symptoms of excess. Some traditional aid recipients are unable to disburse the funds committed to them as a result of what is apologetically termed a 'lack of absorptive capacity'. Whatever the specific reasons for aid overhang in individual countries, the chronic inability of some recipients to disburse aid funds and implement projects provides donors with sound excuses for reducing their programmes.

The argument is also gaining ground that the multilateral system – and the UN in particular – is more than adequately resourced. In many of the UN's programme countries, there are 10 or more full-fledged representative offices of individual UN agencies and organizations – in some countries there are as many as 18. No amount of local consultation under the auspices of a 'resident coordinator' can wholly eliminate the areas of programme overlap, and nothing short of integration will eliminate the multiple duplication of administrative services.

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[34] United Nations, *World Investment Report 1996* (Geneva: UNCTAD, 1996).

[35] 'While a heartening range of countries have been successful in putting in place the prerequisites and then in generating and attracting private flows, many others have only just begun to take the first steps on this path. Against the background of scarce global aid resources, what is required is a combination of policies and efforts to help countries progress steadily from heavy aid-reliance to a strong capacity to raise and attract adequate private financing.' (OECD, op.cit.)

6. REDEFINING DEVELOPMENT COOPERATION

Aid is declining, but not dying. Many of the development assumptions on which the donors based their aid programmes are in question, and these doubts are reflected in falling aid volumes. The decline may be temporary, but it seems likely that aid – as traditionally it has been conceived and provided – may never again reach the levels of the early 1990s.

Does this matter? If some of the analysis about the dynamics of the development process are correct, then more of the same aid will not yield additional benefits either to recipients or donors. The quantity of aid may no longer be critical. Even improvements in aid 'quality' – better targeting, management and coordination – may not make a significant difference to the effectiveness of aid. Aid is still needed, but it must reflect emerging global realities: looser concepts of statehood and the role of governments; a closer meshing (more than merely interdependence) of economic systems; the globalization of media and information exchange. In these circumstances aid will be needed in different forms, and based on different assumptions about the responsibilities of what have hitherto been known as 'donors' and 'recipients'.

A first stage of change will be an end of aid culture. After 50 years, aid and development have almost become mirror images of each other: no aid without development, and no development without aid. This association is unfortunate because it has tended to encourage the idea that development can only proceed with the benefit of aid, and that it cannot proceed without it.

This association has encouraged paternalism in aid relationships and inculcated a culture of dependence in some programme (recipient) countries (Lesson 1 above), resulting in a feeling of helplessness and indignation when aid seems not to be sufficient. A manifestation of the aid culture is the tendency for major development conferences to become aligned into two artificial camps and preoccupied – almost to the exclusion of constructive debate – with the sufficiency or insufficiency of aid resources.

The world has been poorly served by paternalism and dependence. In addition to eliminating terms like developed/developing, donor/recipient and Third World from the lexicon, we should also seek to use the word

'aid' more sparingly. One of the major conclusions of this paper is that an increasingly globalized world is a world in which prosperity will flow from more equitable relationships and more mutuality of assistance; a world of stronger development cooperation through partnerships, or, as the Commission on Global Governance has termed it, 'shared contractual obligation'.

The final sections of this paper describe briefly some of the areas which appear to offer the most promising potential for an expansion of development partnership based on mutual interest and shared obligation. These areas of cooperation provide for all participants to gain, whether the forms of cooperation are bilateral or multilateral. The roles of new 'aid' will be to facilitate and catalyse these areas of cooperation.

6.1 Debt forgiveness

Forgiving the external debts of developing countries became more acceptable in the 1980s, partly as a result of Mexico's inability to continue service payments in 1982. Since then, the forgiveness – reduction, rescheduling and conversion – of debt has become a major global business in itself. Debt burdens – which for poorer countries are usually the result of borrowing for development – are a hindrance to development.

Debt servicing continues to absorb more than 50% of the export earnings of many of the poorest sub-Saharan African countries. In Uganda, the cost is three times the public spending on health. Debt repayments absorb more than half of government revenues in Mozambique and Nicaragua. But the history of debt negotiation has been tortuous and protracted. While creditors have procrastinated before conceding each margin, they have added to the humiliation of the debtors. The Group of 7 largest industrialized countries periodically draws up new terms for official debt (the latest 'Naples' terms date from December 1994), for patient bilateral negotiation through the Paris Club.

In 1996, the Highly Indebted Poor Countries (HIPC) initiative of the IMF and World Bank is the latest attempt to reward good financial behaviour with debt relief. But even on the most optimistic scenarios, the HIPC will only result in a significant easing of the debt for a limited number of countries, and then after several more years. The initiative is fundamentally a financier's tool, requiring slow and painstaking scrutiny of each indebted economy. It is obvious to many observers that the debt

burden will continue to contribute to the demise of many poor people in developing countries who have never seen the benefits of the original loans.[36]

It would be in the interest of all parties if, rather than pursuing incrementalism, new permanent and universal rules could be defined so that, at least for the poorest and most indebted countries (to be identified with clear criteria), the older external debt stock could be written off immediately without close examination of whether 'they have managed to restore a satisfactory economic and financial track record'. Let these debt concessions be accounted in the 'aid' appropriations of the major creditor countries. As major creditors, the Bretton Woods institutions are also part of the debt problem. The causes – and the relief – could be found, at least partially, within their own constitutions.

6.2 Freer international markets

The most recent (Uruguay) round of trade negotiations, leading to the creation of the World Trade Organization, was an important step in the direction of improved global economic governance, even though the WTO can only regulate a fraction of world trade. It came nearly 50 years too late to avoid the adversities of protectionism by the industrialized countries, but it provides a mechanism, which the economically smaller countries can influence, to accelerate the abolition of its more iniquitous remnants, including agricultural protectionism and the multi-fibres arrangement which have only just begun to be phased out.

To take best advantage of the WTO, however, countries need to negotiate favourable terms of accession. Some have succeeded in this, but others have not and need advice to strengthen their negotiating positions. The economically weaker members of WTO need to continue pressing for reform of the global trading rules in their favour and should form alliances to do so. Governments are not the only agents. Since it is the consumers of the world who benefit from lower protectionism, they should also exert more influence on WTO deliberations through the mouthpieces of non-governmental organizations.

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[36] See for example *Poor country debt relief: false dawn or new hope for poverty reduction?* Oxfam Position Paper, April 1997.

Overprotection of weaker trading partners is also not a desirable option. The Economic Union provides assistance to some of its ACP (Africa, Caribbean, Pacific) partners in the form of guaranteed minimum imports of primary commodities at fixed prices. An example is provided by the case of the Caribbean banana, which the US proposes to bring up before the WTO. This kind of aid distorts markets and discriminates against other producers of the same commodities. It is also not in the long term interests of the beneficiaries, since it petrifies their dependence on the export of one commodity and discourages the kind of economic diversification which is ultimately the best means for small countries to maximize their benefits from global trade.

6.3 Aid to end aid

As this paper has already noted, private capital inflows to developing countries, once dwarfed by inflows of official aid, are now greater by a factor of four. Development agencies have warned against the argument that private capital can substitute for aid, on two grounds: that the recipients of these new flows are limited in number, and that the private capital is destined for different purposes.

The spread of private flows is widening, however. India is an example, but there are other countries beginning to undertake economic reforms which have benefited: new ones in Asia (e.g. Vietnam) and eastern Europe, and revived economies in Latin America. Also, this new capital – in the form of foreign direct investment, bonds and equity – is usually productive since it is flowing to companies and ventures which private investors deem to be profitable.

Of course some capital – particularly short-term equity investment – may be volatile and is liable to flow out at the first signs of uncertainty (as in Mexico at the end of 1994). The challenge for the recipient economy, however, is to sustain these inflows and this is where aid-to-end-aid can assist, by overcoming or compensating for market imperfections. Such aid can take the form of helping to develop market-based domestic financial markets, increase the transparency of foreign investment conditions and establish clear legal frameworks for private companies. Aid can also assist governments to open opportunities for investment through the privatization of state assets.

Another variant of aid-to-end-aid concerns some of the smallest and most vulnerable economies, including the small island states, which have never significantly reduced their dependence on aid. It is in their interest, and that of their benefactors, to establish self-managed trust funds into which appropriate multilateral and bilateral sources should contribute grants on a once-for-all basis. Once established, each trust fund would be managed by the country, and guaranteed by one or more of the original benefactors. The country would benefit from interest and capital appreciation, yielding flows of resources at least equal to current aid levels.

6.4 Partnerships and contracting

The principle of shared contractual obligation can take on a number of very practical forms involving two or more partners in transactions of mutual advantage. These contracts can be honoured through payments for services or other cooperative ventures and are already the inspiration for some bilateral and multilateral programmes, but their example could be extended. Countries should be compensated if they are willing to:

- give up armaments or remove anti-personnel mines;
- help to diminish narcotic drug production;
- exert more control over crime and terrorism;
- curb industrial activities which cause trans-boundary air-borne or water-borne pollution;
- control emigration considered excessive by some receiving countries.

The amount of the compensation and the source of payments could either be determined bilaterally or multilaterally, depending on the perceptions of the parties involved about relative costs and benefits. Multilaterally-negotiated regimes and improved information about the causes and consequences of activities in some countries which can compromise or cause harm to others, or threaten peace, would help in making such determinations. Many (starting with Tobin) have proposed global compensation systems, but they can also introduce market distortions. To be workable they need to gain universal acceptance.[37]

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[37] Mahbub ul Haq, Inge Kaul and Isabele Grunberg, *The Tobin Tax: Coping with Financial Volatility* (New York: Oxford University Press, 1996).

6.5 Regionalism

Regional economic co-operation is increasing, and its potential for further growth is considerable. Regional co-operation promotes stability, enlarges markets and encourages the joint management of shared resources.

In the 1990s the European Union has seen an important degree both of widening and deepening of co-operation. More significant for development progress, however, have been the emergence of the North American Free Trade Agreement (NAFTA) linking the US, Canada and Mexico; the formation of Mercosur in Latin America (Brazil, Argentina, Uruguay and Paraguay) and the strengthening of the Association of Southeast Asian Nations (ASEAN) which is expected to reach a membership of ten countries in 1997. Also significant, but less well known are the co-operative groupings which bring together the countries of South Asia, the riverine states of the Mekong, and those of southern Africa. These regional groupings have helped to demonstrate the value of co-operation among countries at different stages of development, based not on donor/recipient relationships, but on mutually beneficial co-operative arrangements.

6.6 The information revolution

The manifestations and the consequences of globalization have been extensively debated in recent years. What can be stated with certainty is that the process is not new. The international economy was arguably more 'globalized' in the 19th Century than it is today, albeit dominated by fewer large powers. But there are important new manifestations of globalization which could have a significant impact on the lives of many millions of people throughout the world. The information revolution is the most significant of these.

The world is currently divided along an information fault-line. The Malaysian Prime Minister said recently: 'it can be no accident that there is today no wealthy developed country that is information-poor, and no information-rich country that is poor and undeveloped'. This may be the most important division in the world today, developmentally speaking: that between the least-informed and the most-informed. The least-informed and the most isolated lack the means to communicate, to gain knowledge, to receive advice, to become empowered to help themselves, and be helped. This is scarcely a new finding: the countries which have advanced furthest

and fastest are those in which the highest investments have been made in education.

What is new is the technological possibility to begin to make a significant difference. Through the wider use of wireless and satellite-based telephony, and the possibilities for communicating through the open standards of the Internet, countries can extend the reach of education through distance learning, can expand the benefits of scientific and medical research, and link people and communities to vast new sources of information. Once these connections have been made, the possibilities exist for more communities to participate in remunerative economic activities, from the modest levels of villages exchanging data on local commodities (as in Indonesia), to the outsourcing of software development and data-base management by multinational corporations (as in India).

The investments required, particularly compared with the enormous potential benefits, are quite modest and no longer depend on the installation of terrestrial telephone grids. There is an extraordinary opportunity for private sector interests to combine with governments and community organizations in emerging countries to help build information infrastructure and make an immediate difference to the development prospects of millions of people.

6.7 Reforming global governance and the UN

It follows that in a world of greater partnership, in which transboundary relationships are growing outside the framework of nation-states, there will be a need for stronger and more variegated mechanisms of arbitration, as well as more elaborate sets of norms and standards. An important start has been made with the series of global conferences held during the 1990s: on education (1990), children's rights (1991), environment (1992), human rights (1993), small island states (1994), population (1994), social development (1995), women (1995), human settlements (1996). Although these conferences have been criticized for being long and wordy, they were significant in bringing countries together at the highest level to recognize and debate common global interests and assist the process of identifying with universal norms.

These conferences underlined the existence of a 'planetary interest',[38] in which the world should be perceived as a continuum of discrete interests aimed at common goals. Just as important was the influence of the large number of non-governmental bodies at these conferences. While these many vocal interests make the task of governance more complex, they enrich the discussions by providing additional information and opinions, and enhance the quality of the decisions taken.

Just as its predecessor had broken important new ground in 1972, the conference which probably made the greatest potential impact was the UN Conference on Environment and Development (UNCED) in 1992, attended by some 1,400 separate non-governmental organizations. UNCED helped to underline the dimensions of the common global interest in the environment, the improved management of which could not be less than the responsibility of all countries together.

In the area of global economic governance, we have discussed the beneficial role which a stronger trade body could play, albeit belatedly. Others have proposed the need for an economic security council under the auspices of the UN which would monitor and assess the state of the world economy and the interaction between major policy areas; provide a strategic framework for stable and sustainable development; bring greater consistency in the policy goals of the IMF, World Bank, WTO and other international organizations; and promote dialogue and consensus – including with major regional organizations – on the evolution of the global international system.

Reform of the UN development system itself is an urgent priority. The system grew up as a rather diffuse collection of agencies, some created 80 years apart, with strong and independent governing bodies and separate funding mechanisms. There is now an urgent need to bring a greater measure of consolidation to the system, refine its operational methods, and strengthen its rule-setting and normative capacities. In 1997 the UN Secretary General will be proposing the first phase of his reform plan. These changes will be only the start. It will be important to plan to move far beyond these proposals in order to position the UN system if it is to play a worthwhile role in the next century.

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[38] Kennedy Graham, *The Planetary Interest*, Global Security Programme Occasional Paper no. 7 (Cambridge University Press, 1995).

FIGURE 1

Aid volume from OECD/DAC countries, 1974-95

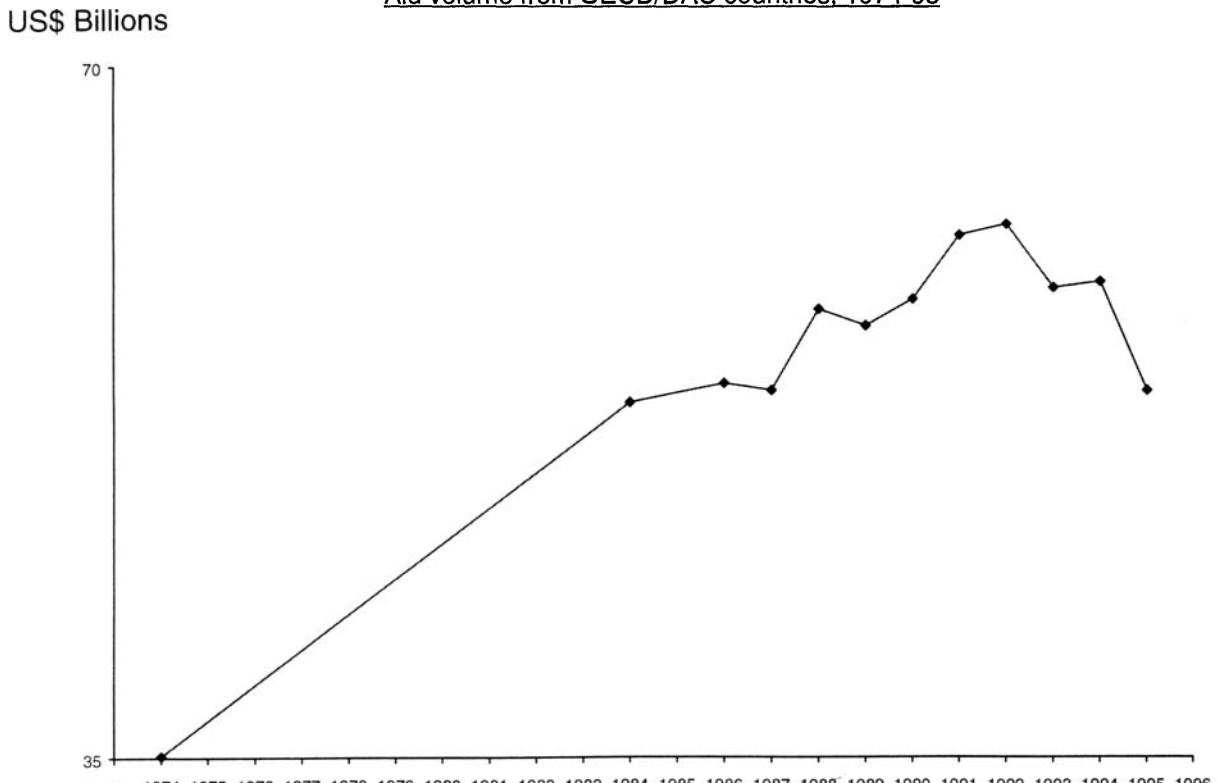
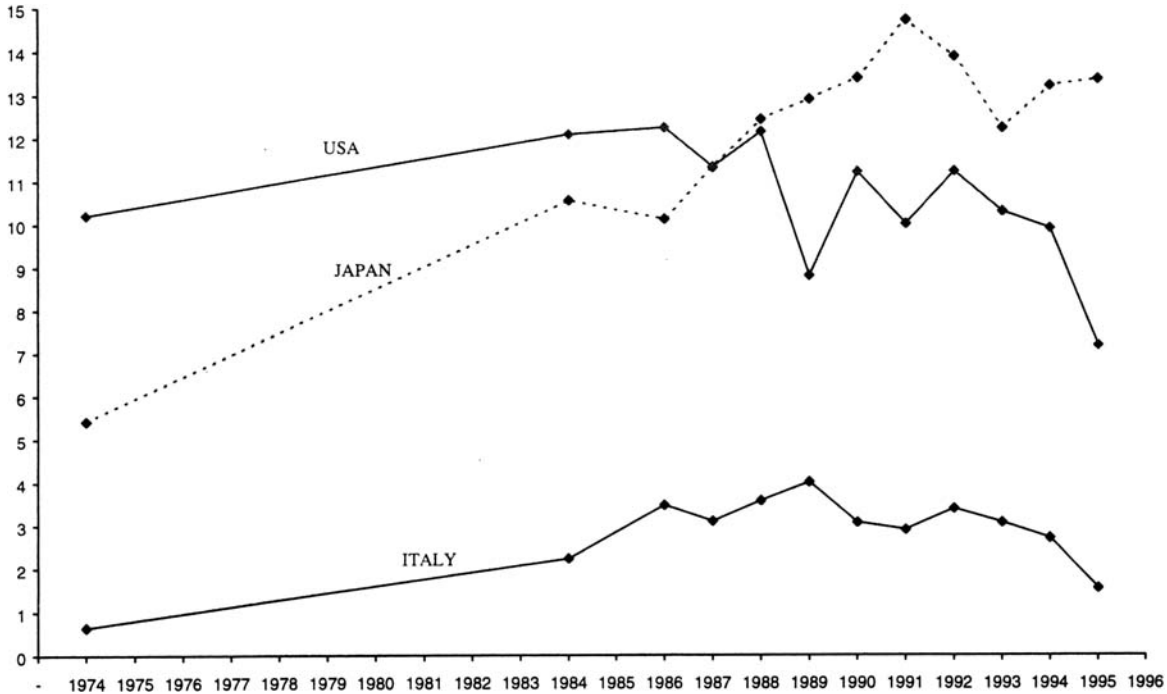


FIGURE 2

Long-term trends in ODA volume*: USA, Japan and Italy, 1974-1995

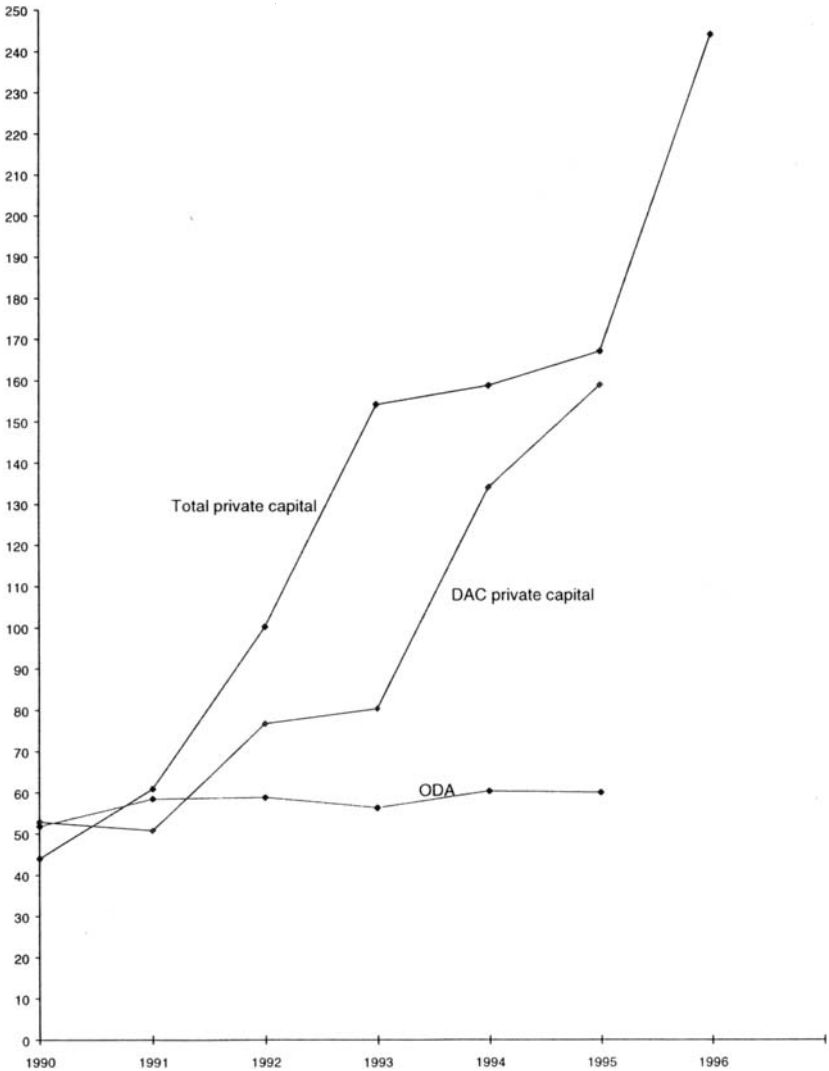


* at 1994 prices and exchange rates

Source: OECD

FIGURE 3

Net flows of ODA and private capital to developing countries at current prices, 1990 -1996



Source: OECD, World Bank

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