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Is Development Aid Superfluous?

The benefits of development aid have been increasingly called into question in recent times. Is such aid superfluous or indeed harmful? Ulrich Hiemenz and Franz Nuscheler address this issue in the following two contributions.

Aid Has Not Lived up to Expectations

by Ulrich Hiemenz, Kiel*

Even in the 1970's the idea that the Third World's economic situation could be substantially improved through financial and technical aid from the industrial countries was still virtually undisputed. However, in the more recent past a thoroughgoing change has occurred. The fact that the gulf between the level of development in rich and poor countries, on average at least, could not be noticeably narrowed, together with a growing mound of reports of development projects which had had detrimental effects on the recipient countries concerned, have led to ever more doubts arising as to the effectiveness of development aid. It is worth noting here that criticism of development aid has been expressed from among the ranks of conservative and progressive (orthodox and non-orthodox) economists alike. The purpose of this article is to reconsider the significance of the development policy pursued by the industrial countries in the light of more recent criticism, and to work out the preconditions necessary for successful development aid.

The industrial countries' development policy, or to put it more precisely the development aid they give, has always been, and to some extent still is, justified on the grounds that the chief obstacle to development is a lack of real capital. The assumption is made that if public funds are made available in the shape of grants and concessional loans it will be possible to enlarge upon inadequate domestic savings in the recipient countries and hence raise their investment levels. Higher investment, the assumption continues, will then accelerate overall economic growth in the Third World, thus contributing to a reduction in the pronounced international differences in income. If growth were to

take a favourable course this would also facilitate the correction of what is felt to be an inequitable distribution of income to the benefit of disadvantaged population groups. In those cases where it was only possible for the primary target groups of development aid, namely the very poor, to benefit – to an inadequate extent – from the induced growth indirectly via trickle-down effects, the belief was that they could derive benefit from the public transfer of capital by having their basic needs satisfied through development aid.

However, a glance at the empirical investigations conducted on the relationships assumed to exist shows that development aid has not done justice to what was expected of it. As far as the relationship between development aid and national savings in the recipient countries is concerned, a number of econometric studies have in fact demonstrated a quite obvious negative influence,¹ though it should be said that this finding has been subject to widely differing interpretations. Empirical tests of the correlation between development aid and overall economic growth in the recipient countries came up with differing results depending on the observation period and the countries chosen. One important conclusion from these investigations, though, is that the growth effects of development aid varied strongly between different groups of developing countries. There are a number of indications that positive stimuli were mainly generated or amplified in those countries which already made a

¹ The following summary of the effects generated by development aid is based on material contained in J. P. Agarwal, M. Dippel, H. H. Glismann: Wirkungen der Entwicklungshilfe. Bestandsaufnahme und Überprüfung für die zweite Entwicklungsdekade. Federal Ministry of Economic Cooperation Research Reports (Forschungsberichte), 50, Cologne 1984, and the comprehensive literature quoted therein.

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relatively large amount of progress, i.e. in middle-income countries, especially in Asia.² On the other hand, growth effects of development aid have apparently largely failed to materialise in those places where they were most urgently needed, e.g. in the poorest developing countries, the African countries and those economies with a strong dependence on raw materials.

No conclusive empirical investigations have been carried out up to now on the distribution effects of development aid within the recipient countries. However, it follows from the disappointing growth effects that, especially for the less advanced Third World countries, even the preconditions for trickle-down effects were missing to a great extent. As for the satisfaction of basic needs, a regression analysis covering more than 80 developing countries was not able to establish that foreign aid had had any positive influence. This "scathing judgement of the efficiency of development aid with regard to the basic needs target"³ hardly needed to be modified when regions were examined individually: for the comprehensive indicator "alteration of life expectancy", statistically significant positive effects could only be ascertained in Asia, but not in Africa or Latin America.

These empirical findings make it clear that development aid has hardly fulfilled the expectations made of it in the past, and that the capital-shortage hypothesis evidently does not tackle the crucial development bottleneck. The lack of (commercial) capital, especially in many African and Latin American countries, is not the chief restriction on development in itself, but is more a symptom of more deep-seated problems such as a lack of the cultural preconditions for growth, social structures which inhibit development, and an unfavourable economic policy setting.⁴ Especially in the poorer Third World countries, these factors have limited the absorptive capacity, i.e. the extent to which development aid can be usefully employed.⁵ Domestic

complementary factors such as local inputs, adequately trained labour and entrepreneurial initiative could often not be provided, or only inadequately. This is also an important reason why the poverty strategies aimed at by the donor countries can also not expect any great success in the future.

Economic Misdevelopments

The dubious success of development aid given to date is, however, also a result of the fact that it has tended to reinforce any misdevelopments inherent in national economic policy rather than ameliorate them, and this applies to microeconomic and macroeconomic levels alike. Even in the event of individual development projects actually standing up to examination using the strictest standards of appraisal, and for many projects this undoubtedly is not the case, it still cannot be guaranteed that the external aid will stimulate the recipient country's development. The official development aid (ODA) attached to specific projects frees national resources in the recipient country. Because of the fungibility of monetary resources, the funds released are then frequently used for projects which are inefficient for the economy as a whole, or for additional consumer spending. Those bearing political responsibility are "often (provided) the financial lee-way (by ODA) to carry through proposals motivated by power politics such as rearmament plans, measures designed to oppress minorities, and projects predominantly serving their own posthumous renown".⁶

Moreover, on a macroeconomic level development aid is liable to reinforce distortions in price structures – and therefore also in production patterns – in recipient countries. In cases where aid primarily takes the form of monetary transfers, there is the danger that the recipient's currency will be overvalued as the supply of foreign exchange tends to increase. This exchange-rate effect discriminates against exporters in the developing countries concerned and against companies competing with foreign suppliers in the domestic market, in favour of the purely domestic sector. Because the latter includes state operations, expansion of bureaucracy is encouraged. In addition, capital as a factor of production becomes cheaper because of the subsidised inflows from abroad, thus encouraging an increase in the capital intensity of production which runs counter to the comparative advantage of most developing countries. Both of these factors encourage false specialisations which, in the medium term, bring debt problems in their wake. The observation that even developing countries whose imports of capital have consisted mainly of development aid credits at rather favourable conditions

² Cf. J. P. Agarwal et al., op. cit.; G. F. Papanek: Aid, Private Investment, Savings and Growth in Less Developed Countries, in: *Journal of Political Economy*, Vol. 81 (1973), No. 1, pp. 120-130; J. M. Downing, U. Hiemenz: Aid, Savings and Growth in the Asian Region, in: *The Developing Economies*, Vol. 21 (1983), No. 1, pp. 3-13.

³ Cf. J. P. Agarwal et al., op. cit., p. 115.

⁴ Cf. J. K. Galbraith: *Economics, Peace and Laughter*, Boston 1971; U. C. Gulati: Effect of Capital Imports on Savings and Growth in Less Developed Countries, in: *Economic Inquiry*, Vol. 16 (1978), No. 4, pp. 563-569.

⁵ Cf. J. B. Donges: *Neue Wege im Verhältnis zu den Entwicklungsländern*, in: H. Giersch (ed.): *Wie es zu schaffen ist. Agenda für die deutsche Wirtschaftspolitik*, Stuttgart 1983, p. 60.

⁶ Cf. H. Giersch: *Entwicklungshilfe anders*, in: *Wirtschaftswoche* of 3. 2. 1984.

have had difficulty in servicing their foreign obligations is a clear indicator of this problem.

In those cases where the transfers provided are mainly in the form of goods, these frequently compete with products which are (or could be) manufactured in the recipient countries themselves. The consequences are primarily evident in the case of longer-term food aid, i.e. aid which is not limited to short-term disaster relief: prices on the domestic markets are suppressed by the foreign supplies of (cheap-rate or donated) products. The remaining incentives for domestic producers are inadequate, with the result that the domestic supply of food goes into decline and, despite their potential to be self-sufficient, countries become increasingly dependent upon foreign aid.⁷

Adverse Political Developments

The misdevelopments in the economic sphere are added to by political and social consequences of development aid which are judged negatively across the board. Since the beginning of the 1980's at the latest, this view has brought unity between schools of thought which have little else in common. Criticism has not come from the donor countries alone,⁸ but has also been

⁷ Cf. B. Fischer, T. Mayer: Mehr Nahrungsmittelhilfe oder Neuorientierung der Agrarpreispolitik in Entwicklungsländern?, in: Die Weltwirtschaft, 1981, No. 1, pp. 163-172.

expressed within developing countries which belong to the favoured recipients of external aid.⁹ There is general agreement in naming the fact that governments of recipient countries are in control of the bulk of development aid received, and can thus use it to extend their own power, as a decisive cause for the far-reaching negative consequences of ODA.

Their power of disposal over the resources transferred allows the ruling elite to carry on with policies which are damaging in overall economic terms – setting artificially low purchasing prices for foodstuffs, forcible collectivisation, discrimination against productive minorities, industrial strategies in disregard of the countries' comparative advantages, and orientation to Western-style educational models are all examples – and to block fundamental reforms (e.g. land reforms) which would be necessary to even create the conditions for overcoming backwardness. To these must be added the negative effects generated by the private sector's reaction to the excessive power of the state. Making

⁸ Cf., e.g., P. Bauer: Entwicklungshilfe: Was steht auf dem Spiel?, Kieler Vorträge (Kiel Lectures), N. F., 97, Tübingen 1982; G. Myrdal: Relief Instead of Development Aid, in: INTERECONOMICS, Vol. 16 (1981), No. 2, pp. 86-89.

⁹ On Bangla Desh, cf. R. Sobhan: The Crisis of External Dependence. The Political Economy of Foreign Aid to Bangla Desh, Dhaka/London 1982; on India see A. L. Bhatia: Does Foreign Aid Help?, Birla Institute of Scientific Research, New Delhi 1981.

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efforts of one's own in the economic field is often regarded as no longer worthwhile or, in view of foreign aid inflows, as dispensable. Recipients become increasingly dependent on further transfers of resources, while donors are faced with the "Samaritan's dilemma" as the initial support provided gives rise to ever more need for help.

Options for Improvement

In view of these experiences, development aid cannot be expected to produce better results if the donor countries – as is still frequently demanded – step up their efforts above past levels or seek to achieve qualitative improvements by restructuring budgets in favour of projects which are smaller and/or more strongly oriented towards basic needs. Instead of this it is essential to undertake a fundamental reorientation. There are three paths available to achieve this which must be jointly embarked upon.¹⁰

Firstly, in place of permanent support a larger amount of short-term emergency relief should be provided to ease acute distress in the wake of natural catastrophes etc., yet to prevent lasting dependence of the recipients on development aid and avoid the donors being faced with the "Samaritan's dilemma". In order that the aid can reach its target groups with as little depletion as possible, it should no longer be paid to developing countries' governments, but should, under the donors' supervision, be handed over to non-governmental organisations able to take charge of the distribution via direct contact with those in need. The privatisation of the transfer of resources to the Third World is not only a recommended course at the receiving end. There ought to be a simultaneous shift on the donor side towards private aid organisations. Even those who reject state development aid of whatever kind do admit that the damaging effects which have been diagnosed in this area are largely absent in the case of private resource transfer.¹¹ Placing a greater amount of external aid in the hands of non-governmental agencies means making the provision of resources more efficient by largely eliminating bureaucratic obstacles, lowering administration costs and overcoming political opportunism. Taxpayers in the industrial countries could be offered the possibility of paying over a predetermined part of their tax liability to recognised private development aid organisations instead of to the inland revenue.¹²

However, the effectiveness of any aid – whether provided by the state or by non-governmental agencies – is inextricably bound up with the macroeconomic conditions prevailing in the recipient countries.

Successes in development cooperation with the Third World can only be expected in the long run if these overall conditions encourage private initiative rather than smothering it. The first point which would need to be borne in mind in such an efficiency-oriented provision of resources is that development aid should not have a stop-gap function. Developing countries which deliberately close themselves off from world markets, which impose prohibitions on capital imports, are subject to capital flight or which discriminate in their economic policy against ethnic and religious minorities, should not have their policies backed up by development aid. Development aid tends to perpetuate such practices rather than help to eliminate them.

Efficiency-oriented provision of resources can only be achieved if development aid is linked from the outset to conditions which appear to be important for the effectiveness of that aid. Among such conditions are¹³

- balanced consideration given to agricultural development, craft trades and small to medium-sized businesses (as these areas can be presumed, as recent investigations show, to have a substantial potential for growth),
- agreement to refrain as far as possible from administrative interference in the domestic factor and goods markets in the form, for example, of maximum price regulations for foodstuffs and mineral products, services and interest rates (because these regulations contribute to the persistence of chronic supply bottlenecks),
- agreement to refrain from inflationary monetary and fiscal policies (because these reduce the propensity to save and distort the investment structure),
- increased protection of ownership both for domestic and foreign investors (because this attracts investment).

Donor countries may attempt to achieve such changes in economic policy using the soft approach of political dialogue or the hard approach of attaching specific conditions to state development aid. If such improvements in the economic policy setting were to be brought about using the lever of development aid, and of

¹⁰ On this point, cf. also P. N u n n e n k a m p : Entwicklungshilfe zwischen Anspruch und Wirklichkeit, Kieler Diskussionsbeiträge (Kiel discussion papers) 115, Oct. 1985, p. 16 ff.

¹¹ Cf. P. B a u e r , op. cit.

¹² Cf. H. G i e r s c h : Korruption als Hindernis: Nichtstaatliche Entwicklungshilfe hätte größere Erfolgchancen, in: Rheinischer Merkur/Christ und Welt of 13. 1. 1984.

¹³ Cf. also V. K ö h l e r : Should Aid be Abandoned?, in: Development and Cooperation, 1985, No. 1, pp. 4-7; also J. P. A g a r w a l et al., op. cit., p. 137 ff.

programme aid in particular, then this would already imply such a degree of success for development policy that the efficiency in the development of the resources themselves would no longer be such a key issue. For the more the growth forces within the developing countries themselves are stimulated, the more strongly incomes rise, domestic savings increase and human capital expands, meaning that development aid in its traditional sense becomes superfluous.

Improved Review of Success

Even if new paths are embarked upon in the granting of development aid, evaluation of the success of the schemes involved remains essential. The evaluation process should not simply be addressed to the individual goals applying each time aid is given, but should at all events also take overall economic effects of the aid into account. Up till now success evaluation has primarily been conducted by the institutions who are themselves responsible for the provision of the resources. This is not an appropriate solution; reviews of efficiency where the provision of public money is concerned should always be carried out by institutions

or persons who have no involvement in providing the funds. In order to avoid giving the impression – even here – that those responsible have any direct interest in the result of their enquiry, success evaluation should be carried out by institutions or persons who are changed on an irregular basis.

Throughout the above, it should not be forgotten that development policy has to begin here at home in the industrial countries. Part and parcel of development policy should be that the industrial countries permit structural change to occur in their economies, and cut down on the multitude of state interventions in the market process. For example, as long as the EC, with its misguided agricultural policy, contributes to a situation in which it is more attractive in the short term for Third World countries to import EC surplus production at subsidised prices than it is to make proper use of their own agricultural potential, one can hardly hope that the policy dialogue will have any sweeping effect. To the extent that industrial countries close off their markets to exports from developing countries, they share responsibility for the continuing dependence of the Third World on external assistance.

A Qualified Plea for Development Aid

by Franz Nuscheler, Duisburg*

State development aid has always been subjected to criticism. Now, however, it is entwined in a deeper crisis of justification than ever before. This observation appears a paradoxical one, as surveys in various Western countries have actually found growing support for the idea of development aid among the population at large. Moreover, in most Western countries that population has demonstrated an unprecedented willingness to make donations in the international “food aid for Africa” campaign.

The paradox soon disappears if the distinction is drawn between economic assistance or official aid on the one hand and disaster or famine aid on the other. On the strength of humanitarian or charitable motives, people do want to help if they are convinced that they

can save lives – in concrete, visible, sensually perceptible terms – from the threats of hunger and destitution; but aid for development in the sense of structural changes taking effect over a long time period, of growth or of increased productivity, remains an abstract and demotivating matter. This is added to by the fact that many people, and indeed those groups who are particularly closely involved and well informed, distrust the use of official aid on the part of both donor and recipient countries, and this with good reason. It is this informed criticism in particular which is nurturing a broad “aid pessimism” in many countries today.

Criticism of governmental development aid is really nothing new; it has occurred for as long as transfer payments with the lofty aim of overcoming underdevelopment and encouraging development in the poor countries of the world have existed. Even the

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