

# Foreign Aid Policy: The Lessons Learned **2**

**F**oreign aid has a very long and distinguished tradition. In the fifth century B.C., for example, the Delian League—an early defense support agreement—provided financial aid to Athens, so that the Athenians could build a navy capable of containing Persian imperial ambitions, thereby protecting the entire region.<sup>1</sup> Centuries later, Napoleon similarly used money to gain allies to support his military ventures across the European continent.<sup>2</sup> Likewise, the French government, under Louis XVI, provided aid to American revolutionaries not for altruistic reasons but rather to strengthen France’s international position vis a vis Great Britain.<sup>3</sup>

This centuries-old practice of granting aid to foreign governments in order to shore up a state’s own situation reflects a basic awareness of, and appreciation for, the essential interdependence of peoples across the globe. It suggests,

moreover, that foreign aid can perhaps best be viewed not as an end in and of itself, but rather as a basic and well-trying, policy tool that can be used to foster a range of national goals in the international arena. Whether foreign aid is the appropriate foreign policy tool in any given instance will depend, in part, on world events and the configuration of the world order.

Using foreign aid as a policy tool has special relevance for today. Never before has the world been so integrated, or have states been so interdependent. Now that advanced communication and information networking technologies—operating in real time—span the globe, gyrations in the Japanese stock market are experienced throughout the world within one business day; prior to the development of the transatlantic cable in 1866, it took six weeks for stock prices to clear between London and New York.<sup>4</sup> Likewise, with instantaneous worldwide news coverage and

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<sup>1</sup> Delos—the smallest of the Cyclades islands, which are located in the Aegean sea—was a major commercial center as well as the treasury of the Greek confederacy during the Persian wars in the late sixth century B.C. See, for a discussion, Rex Warner, trans., Thucydides, *History of the Peloponnesian War* (London, UK: Penguin Books, 1954), p. 92.

<sup>2</sup> W.W. Rustow, *Eisenhower, Kennedy, and Foreign Aid* (Austin, TX: University of Texas Press, 1985), pp. 75–76.

<sup>3</sup> Robert Middlekauf, “The Revolution Becomes a European War,” *The Glorious Cause: The American Revolution, 1763–1789* (New York, NY: Oxford University Press, 1982), chap. 7.

<sup>4</sup> Kenneth D. Garbade and William L. Silber, “Technology, Communication, and the Performance of Financial Markets 1840–1975,” *Journal of Finance*, vol. 33, June 1978, pp. 819–832.

rapid diffusion of technologies such as the Internet, the media can now determine whether an issue—such as the famine in Somalia or the revolt in Chiapas, Mexico—is placed on the international political agenda.

Complicating matters, the collapse of the Communist regimes in the Soviet Union and Eastern Europe has rendered the old world order based on a Cold War balance of power obsolete, while a new basis for world stability has yet to emerge.<sup>5</sup> Lacking the threat of a major nuclear war, the incidence of local quarrels and conflagrations has already increased. The year 1992, for example, bore witness to more than 200 wars.<sup>6</sup>

At the same time, the number of highly complex and unprecedented social and economic issues that need to be addressed at the global level is on the rise. Just as national boundaries are increasingly penetrable to the flow of commerce, ideas, and people, so too these boundaries can no longer constrain the spread of social, economic, and environmental problems.<sup>7</sup> In the future, the dangers to national security may stem less from the outbreaks of war among nation states, and more from the disintegration of civil society and the depletion of the world's human and environmental resources.<sup>8</sup>

As in the past, policymakers can look to foreign aid as one way of coping with these highly complex and unprecedented foreign policy issues. Despite years of experience, however, designing successful policies to address such problems continues to be fraught with difficulties. The relationship between foreign assistance and national goals such as national security, political stability, and economic development is by no means straightforward. Moreover, all too often policymakers have drawn the appropriate lessons from one set of foreign aid experiences,

only to have had the situation change so that new solutions and approaches are required.

This chapter reviews the lessons to be learned from past U.S. efforts to employ foreign aid policy to achieve national goals. On the basis of this analysis, it suggests a number of criteria that policymakers will need to take into account in developing telecommunication-related approaches for providing foreign assistance.

## FOREIGN AID AS A POLICY TOOL: THE IDEAL CASE

To understand how telecommunication-related aid policies might mutually serve and perhaps even reinforce foreign policy and foreign trade goals, it is helpful first to consider the foreign aid process—in the abstract—as an “idealized” system in which foreign aid serves as a policy tool that aims to promote national security and international economic objectives (see figure 2-1). By examining how the process is intended to work—the assumptions on which it is based and the conditions required for success—it is possible to identify and analyze potential problem areas, as well as the points in the process where telecommunication and information might best contribute.

### ■ Foreign Aid Goals and Policy Tools

Over the past 50 years, the United States has employed foreign aid to achieve a number of national goals. Aid has been provided, for example, for humanitarian reasons; to promote worldwide security and political stability; to support economic development and growth in trade; to maintain the integrity of the international monetary system; as well to foster democracy and protect the environment (see table 2-1). Although program emphasis has changed over time and in

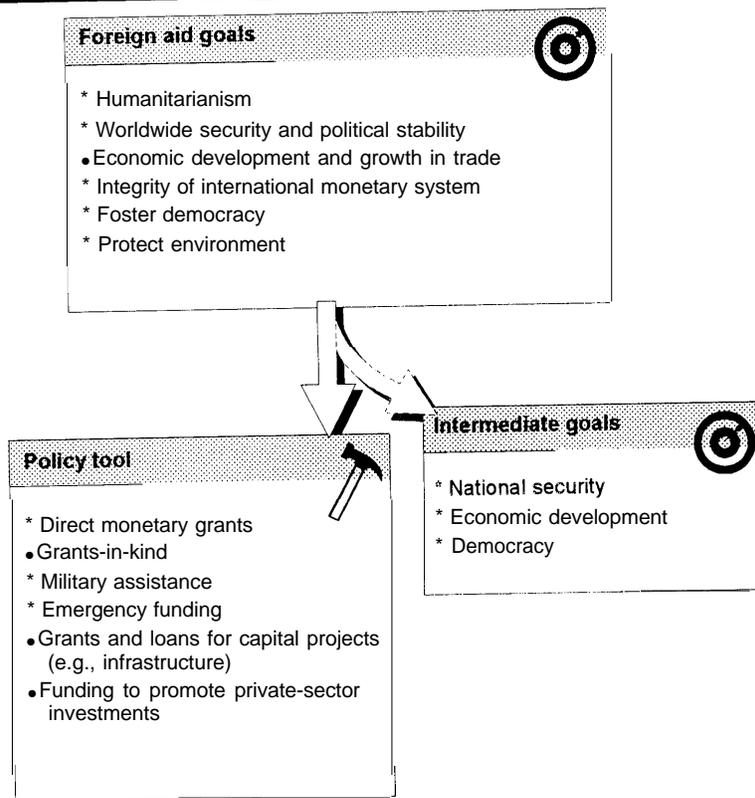
<sup>5</sup> *The Quest for World Order, Daedalus*, Journal of the American Academy of Arts and Sciences, summer 1995; see also *Current History, Global Security*, entire issue, May 1995.

<sup>6</sup> Benjamin Barber, “Jihad vs. MacWorld,” *The Atlantic Monthly*, March 1992, pp. 53–63.

<sup>7</sup> Paul David Miller, “Leadership in a Transnational World: The Challenge of Keeping the Peace,” National Security Paper No. 2, Institute for Policy Analysis, 1993, p. 19.

<sup>8</sup> See Robert D. Kaplan, “The Coming Anarchy,” *The Atlantic Monthly*, February, 1994.

FIGURE 2-1: Conceptualization of Foreign A



SOURCE: Office of Technology Assessment, 1995.

response to different circumstances, the range of policy goals has remained fairly consistent.

Almost all these previous goals are echoed, for example, in the Foreign Assistance Act of 1994, which—replacing the Foreign Assistance Act of 1961—is intended to reshape the foreign aid program, linking it closer to overall foreign policy goals and the post-Cold-War international environment. This legislation incorporates six, interrelated objectives:

1. ensuring the economic competitiveness and security of the United States;
2. supporting reform in Russia and the New Independent States of the Former Soviet Union;
3. renewing and revitalizing our critical security relationships with the North Atlantic Treaty Organization (NATO) and Europe;
4. expanding economic and political cooperation across Asia and the Pacific;
5. forging an enduring peace in the Middle East; and
6. meeting the challenges to American security posed by global problems like proliferation, environmental degradation, excessive population growth, narcotics trafficking, and terrorism.

Over the years, the U.S. government has used a variety of policy tools to achieve its foreign aid goals. Included among these, for example, are direct monetary grants and grants-in-kind for humanitarian purposes and basic human needs, military assistance, emergency funding to support exchange rates in times of financial crisis, grants and loans for special capital/infrastructure-related projects, funding to insure private sector investments against excessive risks, etc. These policy tools are used, moreover, by a wide range of aid organizations—public, private, national, regional, and/or multinational alike.

TABLE 2-1: Development Ideas and U.S. Aid Rationales 1950–1990

	Ideas	Rationales
1950s	Reconstruction of Europe Establishment of Bretton Woods System Containment	Humanitarian, development, commercial Development, security Security
1960s	Stages: growth-stability State-led growth Import substitution industrialization (ISI)	Development, humanitarian, security Development Development, security
1970s	Basic needs New international economic order (NIEO)	Humanitarian, development
1980s	Policy reform Export-led growth Democracy	Development, security, humanitarian Development, security Development, security
1990s	Broad-based & sustainable development growth, democracy, environment, population	Economic security Human development

SOURCE: U.S. Congress, Senate, Committee on Foreign Relations, Subcommittee on International Economic Policy, Trade, Oceans and Environment Affairs, *Hearings on Foreign Aid Reform*, hearing, Feb. 9, 22 and Mar. 3, 1994, S. Hrg. 103-560 (Washington, DC: U.S. Government Printing Office, 1994).

Generally speaking, the choice of policy tools depends on factors such as historical interrelationships and geographic boundaries, policymakers' values and perceptions of the problem, available resources, and the mandates of funding organizations, as well as the overall political and economic context in which foreign aid organizations operate. Whether a given policy tool leads to a successful outcome is related to factors such as the worldwide economic environment; the situation and organizational context in which a program is implemented; its suitability for the task at hand; and the quality of its execution.

### ■ Achieving Intermediary Goals

As the arrows in figure 2-1 indicate, foreign aid policies are intended to promote national security and broad national economic goals indirectly, by supporting economic development, democracy, and political stability in select regions of the world. Thus, how well these tools accomplish their long-term national objectives will depend to a large degree on their ability to deal with these intermediary social, economic, and political challenges. Achieving success requires that policymakers fulfill a number of conditions, all of

which are extremely difficult to meet. Policymakers must have a reasonable understanding of the process of economic development, the nature of democracy, and the impact of social and cultural forces. Moreover, they must be able to adequately identify and evaluate problems, and develop the capacity and leverage to assure that necessary adjustments are made.

### ■ Longer Term Outcomes

Worldwide economic development is intended to serve U.S. interests in at least two important, and presumably, complementary ways. Foreign aid programs, which promote economic development, aim to enhance stability in areas that are threatened by forces inimical to the values and/or security of the United States. At the same time, economic growth and development also serve U.S. economic interests. They not only foster stable worldwide economic institutions, which are required for conducting business on a global basis; they also help to generate a growing market for U.S. goods and services. U.S. environmental goals are also served to the extent that foreign aid encourages sustainable economic development.

Judging how well foreign aid has served the interests of the United States is quite difficult, given the complex set of factors involved. When viewed on a project basis, and in terms of economic measures and goals alone, foreign aid programs have generally been rated successful, exhibiting high average rates of return.<sup>9</sup> But ascertaining how such projects contribute to overall economic growth and development in developing countries is far more difficult.<sup>10</sup> Generalizations about whether or not foreign assistance contributes to the achievement of noneconomic goals—such as national security, democracy, and political stability—are even more problematic.

Clearly, all foreign assistance is not alike. The impact of foreign aid depends not only on the nature of the aid given but also on how it is used by the recipients of aid. To understand the range of possible outcomes, and the factors likely to influence them, it is necessary to look more closely—in light of past experiences—at the assumptions on which the U.S. foreign policy rationale has been based.

## THE HISTORICAL EXPERIENCE

The uneven performance record of U.S. foreign aid programs is due in part to the fact that many of the assumptions on which these programs were based are, in today's context, less tenable. If communication-based foreign aid programs are to exhibit greater success, they must be founded on a solid, up-to-date rationale that incorporates the many lessons from the past.

## ■ The Marshall Plan: The Source of the Model

The U.S. foreign aid program dates back to the end of the Second World War, when world conditions generally conformed to the assumptions underlying the model outlined above. Perceiving the Soviet Union to be a major threat to both national security and the American way of life, the United States sought to contain it by bolstering the economies of countries most vulnerable to the appeals of communism. To this end, the United States invested more than \$13 billion over a 5-year period, under the auspices of the Marshall Plan, to help rebuild and sustain the war-torn economies of Europe.<sup>11</sup>

Motivated by self-interest as well as generosity, this aid was not without conditions. Countries receiving aid had to provide matching funds in local currencies, which were to be used to improve the productive capacity of industry, agriculture, and infrastructure. U.S. administrators also advised European governments on how these matching funds should be used. In addition, each aid recipient had to agree to balance its budget, free prices (hitherto controlled), halt inflation, stabilize its exchange rate, and devise a plan for removing most trade controls.<sup>12</sup> Moreover, to promote West European integration, the Marshall Plan required European governments to coordinate and jointly allocate American aid through a new organization created for this purpose—the Organisation for European Economic Cooperation (OEEC), which later became the Organisation for Economic Cooperation and Development (OECD).

<sup>9</sup> Constantine Michalopoulos and Vasant Sukhatme, "The Impact of Development Assistance: A Review of the Quantitative Evidence," in Anne Krueger and Vernon W. Ruttan (eds.), *Aid and Development* (Baltimore, MD: Johns Hopkins Press, 1989), chap. 7; and Roger C. Riddell, *Foreign Aid Reconsidered* (Baltimore, MD: Johns Hopkins Press, 1987), p. 126.

<sup>10</sup> *Ibid.*

<sup>11</sup> Anne Krueger estimates this amount to be \$55.4 billion in 1991 prices, or an average annual total of \$13.8 billion. See Anne O. Krueger, *Economic Policies at Cross Purposes: The United States and the Developing Countries* (Washington, DC: The Brookings Institution, 1993), p. 200; See also Alan S. Milward, *The Reconstruction of Western Europe 1945–1951* (University of California Press, 1984); and Stanley Hoffman and Charles Maier (eds.), *The Marshall Plan: A Retrospective* (Boulder, CO: Westview Press, 1984).

<sup>12</sup> See Michael D. Bordo, "The Gold Standard, Bretton Woods and Other Monetary Regimes: A Historical Appraisal," *Federal Reserve Bank of Saint Louis*, March/April 1993, p. 166. See also "Bretton Woods Revisited: A Gift From the Cold War," *The Economist*, vol. 332, No. 7871, July 9, 1994, pp. 69–75.

These conditions closely linked the Marshall Plan to U.S. international trade and financial policies. Attributing the outbreak of hostilities in World War II, in part, to the collapse of the worldwide trading and financial systems, the United States led the way in establishing a postwar open trading and monetary system based on a set of multilateral economic institutions. Had the European countries not had access to Marshall Plan aid, they would have been unable to conform to these requirements for openness.

The cornerstone of the new economic order was the Bretton Woods Agreement of 1944, which called for the establishment of the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD), and the General Agreement on Tariffs and Trade (GATT).<sup>13</sup> The IMF was set up to manage the orderly transition of world currencies, by providing temporary funding to those countries experiencing severe balance of payments difficulties. Complementing this role, the IBRD (subsequently, the World Bank) was designed to promote the flow of funds to developing countries. The GATT, which was intended to be subsumed within the—subsequently aborted—International Trade Organization (ITO), was charged with trade liberalization.<sup>14</sup>

Together, these programs and institutions were highly successful in fostering postwar economic reconstruction. By 1950, European production levels were 25 percent higher than in 1938. And, in the three years between 1947 and

1950, agricultural output increased by one-third. During the same time, the European trade deficit fell from \$8.5 billion to \$1 billion.<sup>15</sup> In 1952, Europe generated a current account surplus and by 1955, all European currencies were virtually convertible.<sup>16</sup>

The United States similarly benefited from the Marshall Plan and Bretton Woods arrangements. Worldwide trade flourished in this stable economic environment. Between the years 1950 and 1960, for example, the value of world trade increased from \$57 billion to \$144 billion, growing faster (in real terms) than output.<sup>17</sup> In the same period, U.S. exports totaled 5 percent of gross national product (GNP), with 62 percent of these exports going to industrialized countries.<sup>18</sup> Judged, therefore, solely on the basis of U.S. trade goals, the American investment in Europe appears to have “paid off.”<sup>19</sup>

At the same time, postwar economic arrangements also served U.S. security goals, which had become increasingly paramount in the face of a mounting Soviet threat.<sup>20</sup> By requiring European countries to collaborate within the OEEC, the Marshall Plan helped ameliorate potential conflicts among U.S. allies, thereby fostering European unity. Without such European cooperation, NATO—on which U.S. defense strategy in Europe depended—could never have succeeded.<sup>21</sup>

The United States gained, moreover, in a much more fundamental and enduring way from

<sup>13</sup> Ronald I. McKinnon, “The Rules of the Game: International Money in Historical Perspective,” *Journal of Economic Literature*, vol. 31, March 1993, p. 12.

<sup>14</sup> The General Agreement on Tariffs and Trade (GATT) was originally conceived as a holding operation until the ratification of the treaty establishing the International Trade Organization (ITO). When the U.S. Congress failed to ratify the treaty, GATT came to serve as the operational mechanism through which trade liberalization was negotiated. See Patrick Low, *Trading Free: The GATT and U.S. Trade Policy* (New York, NY: The Twentieth Century Fund, 1993).

<sup>15</sup> Organisation for Economic Cooperation and Development, *From Marshall Plan to Global Interdependence* (Paris, France: OECD, 1978); see also Robert Solomon, *The International Monetary System 1945–1976: An Insider’s View* (New York, NY: Harper and Row, 1976).

<sup>16</sup> Bordo, *op. cit.*, footnote 12, p. 166.

<sup>17</sup> Krueger, *op. cit.*, footnote 11, p. 12.

<sup>18</sup> *Ibid.*

<sup>19</sup> As described in *The Economist*, *op. cit.* footnote 12.

<sup>20</sup> When Marshall presented his plan at Harvard University in June 1947, he left the door open to the Soviet Union and the Eastern Europeans to join the program, an offer that was turned down. As a result, the Marshall Plan came to be identified with the U.S. policy of containment. See Stephen Browne, *Foreign Aid in Practice* (New York, NY: New York University Press, 1991), p. 12.

<sup>21</sup> Melvyn P. Leffler, *A Preponderance of Power: National Security, the Truman Administration, and the Cold War*, (Stanford CA: Stanford University Press, 1992).

these developments. As the chief financier of postwar reconstruction, the United States was successful in influencing the economic rules of the global marketplace so that they mirrored and reinforced American economic and political values.<sup>22</sup> Thus, for example, participation in the GATT was made contingent on a country's acceptance of free market principles. And, on that basis, the Soviet Union and the countries of Eastern Europe were excluded from the worldwide trading system.

Because of its widely acclaimed success, the Marshall Plan served as the inspiration for U.S. bilateral aid to the developing countries.<sup>23</sup> As it turned out, however, the Marshall Plan model could not be easily replicated. Where conditions diverged greatly from those in Europe, it yielded some very different, and oftentimes unexpected, results. Key to the Marshall Plan's success was the sheer magnitude of the financial commitment, a mutual purpose and atmosphere of trust, the application of—what were generally agreed to be—sound economic policies, and the existence of a social and economic infrastructure capable of absorbing and efficiently allocating aid resources.<sup>24</sup>

### ■ Aid for Development in the Context of the Cold War

Postwar conditions in the developing world differed radically from those in Western Europe. Most less developed countries had only just achieved independence, and their leaders—however capable—were as yet untried. The task of

nation building, which lay before them, was enormous. Rarely, if ever, did the geography, history, and culture of these “nations” coincide. The developing countries were, moreover, extremely poor. For the most part, their economies were agriculture based, and thus dependent on primary products for foreign exchange and imports. Low standards of living, low savings rates, high illiteracy rates, and relatively low life expectancies were also common. These problems were of such magnitude, in fact, that many leaders in the developing world believed that they could only be overcome given very rapid economic development.<sup>25</sup>

This diagnosis was shared in the West. Impressed by the results of the Marshall Plan, Americans, in particular, were generally sympathetic to the notion of providing support to developing countries. Most people agreed, moreover, that what was needed was the transfer of capital and technology expertise. President Truman captured this vision in his 1949 inaugural address, when, as his fourth major point, he called for a technical assistance program for developing countries.<sup>26</sup>

The altruistic motives that inspired Truman's Four-Point Program were soon superseded, however, by national security concerns. By 1953, \$4.5 billion—that is to say, 70 percent—of all U.S. aid appropriations went to direct military aid; another 20 percent took the form of economic assistance to less developed military

<sup>22</sup> Robert Gilpin, *The Political Economy of International Relations* (Princeton, NJ: Princeton University Press, 1987), pp. 131–134; and Charles W. Kelley and Eugene R. Wittkopf, *American Foreign Policy: Pattern and Process, 3rd ed.* (New York, NY: St. Martin's Press, 1987), p. 151.

<sup>23</sup> As described by Paul Hoffman, an early administrator of the Marshall Plan, “We have learned in Europe what to do in Asia, for under the Marshall Plan, we have developed the essential instruments of a successful policy in the arena of world politics.” Paul G. Hoffman, *Peace Can Be Won* (New York, N.Y.: Doubleday, 1951), p. 130. Writing from an historical perspective, Albert Hirschman concurs. As he describes, the Marshall Plan convinced policymakers that “the infusion of capital helped along by investment planning might be able to grind out growth and welfare all over the globe.” A. Hirschman, “Rise and Decline of Development Economics,” in M. Gersovitz, et al. (eds.), *The Theory and Experience of Economic Development* (London, UK: Allen & Unwin, 1982), p. 380.

<sup>24</sup> Browne, op. cit., footnote 20, p. 13.

<sup>25</sup> Krueger, op. cit., footnote 11.

<sup>26</sup> David McCullough, *Truman* (New York, NY: Simon and Schuster, 1992), p. 729–731. See also Gregory A. Fossedal, *Our Finest Hour: Will Clayton, the Marshall Plan, and the Triumph of Democracy* (Stanford, CA: Hoover Institution Press, 1993).

allies.<sup>27</sup> Once the Cold War had been brought to a standstill in Europe, hostilities shifted to East Asia. In June 1950—the same year that the U.S. Congress passed the Act for International Development—North Korea invaded South Korea. With the Soviet Union aiding the northern half of the peninsula and the United States fighting on behalf of the south, U.S. foreign assistance was quickly channeled to the immediate military objective of halting the Communist advance.<sup>28</sup>

When the fighting ended, the Cold War shifted to more ideological battlegrounds, where foreign assistance again played a critical role. Seeking to extend their spheres of influence at one another's expense, the United States and the Soviet Union sought to curry the developing countries' favor by proffering aid. Asia was a key target of this competition. Including countries such as India, Indonesia, Pakistan, the Philippines, and Sri Lanka, which together accounted for a large proportion of the developing world's population, Asia was considered to be more strategically situated than the regions of Africa or Latin America.

Despite such superpower overtures, the newly independent countries were not successfully swayed by either camp. Meeting in 1955 at the Afro-Asian Conference held in Bandung, Indonesia, they announced their joint decision to remain nonaligned. Whether intended or not, this decision served to raise the ante for granting foreign aid. Thus, for example, the United States increased its aid to Indonesia, on learning that the Indonesian government had accepted a \$100 mil-

lion loan from the Soviet Union. Similarly, the Indian government, by remaining nonaligned, was able to procure funds and credits to finance its Second Five-Year Plan from the governments of the Soviet Union, the United States, and Western Europe alike.<sup>29</sup>

The Cold War thus set a tone for U.S. development assistance that survives to some extent today. Judged in the context of the period, and by the overriding goal of containing communism, U.S. aid policy was certainly a success. Measured in terms of Truman's Four Point Program, however, U.S. aid did not have its intended effect. In fact, in some cases, it proved detrimental. When foreign loans increased a developing country's liability without improving its growth potential, they served to make the recipient country further dependent on aid.<sup>30</sup>

The contrast between U.S. aid policy in Europe and in the developing countries is striking. In devising the Marshall Plan the United States worked closely with European countries to develop a workable aid package that took into account social and economic factors. In fact, because of the importance attributed to social and economic factors, the United States made aid to Europe contingent on European cooperation and on fundamental economic reforms. In the developing countries, no similar dialogue ever took place. Equally, if not more important, the basis for granting aid to developing countries was political correctness rather than economic soundness.

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<sup>27</sup> Subsequently, until the early 1960s, all U.S. foreign aid was administered by the Mutual Security Agency, which specified that aid would be contingent on whether it "strengthened the security of the United States." In keeping with these new guidelines, the United States had, by the end of the war, not only invested \$50 billion in South Korea's democratic future; it had also deployed more than two million troops there. David Louis Cingranelli, *Ethics, American Foreign Policy, and the Third World* (New York, NY: St. Martin's Press, 1993), p. 138; and Browne, *op. cit.*, footnote 20, p. 134.

<sup>28</sup> According to Cingranelli, "Between 1946 and 1950, about 90 percent of the bilateral aid provided to less developed countries was for economic development. With the outbreak of the Korean War in 1950, military aid began to dominate accounting for two-thirds of the total by 1953." *Ibid.*

<sup>29</sup> The developing world's policy of nonalignment also had its downsides. Using the stick as well as the carrot, the United States denied assistance on a number of occasions for political reasons. Thus, for example, when Egypt began to establish closer ties with the Soviet bloc in 1955, and signed an arms agreement with Czechoslovakia in 1956, the United States canceled its offer to help finance the Aswan Dam, as did the United Kingdom and the World Bank—the only other sources of noncommunist funding. Browne, *op. cit.*, footnote 20.

<sup>30</sup> This is a criticism that has been made from all sides of the political spectrum. For an overview, see Riddell, *op. cit.*; footnote 9.

## ■ An Expanding Foreign Aid Environment

By the late 1950s, the rigid bipolar pattern of distributing aid began to erode. New kinds of foreign aid programs and rationales were introduced to take into account the growing evidence and data on economic development. Similarly, new players with their own agendas were becoming involved, including among them a number of multinational organizations. The developing world was also emerging as a political force in its own right. Given this increasingly fluid international political environment, the United States had less freedom to link foreign aid to foreign policy and trade goals or leverage to control policy outcomes.

The narrow choice of foreign aid tools reflected a lack of understanding and empirical evidence about the nature and process of economic development.<sup>31</sup> Given little experience with the newly independent countries, American policymakers attributed their poverty to a lack of domestic capital required to fuel industrialization. Accordingly, they concluded that these countries merely needed foreign capital. Because the Congress was generally opposed to aid for purposes other than military security, however, most aid was provided on a loan rather than a concessionary basis.<sup>32</sup>

When industrialization was not immediately forthcoming, funders recognized that Third World countries could not borrow and repay loans as did developed countries. The IBRD, for example, lent money at near market interest rates, so it was only natural that—especially in the early years—Japan and the countries of Europe were its major clients. To meet the Third

World's special needs, the United States—in 1959, at the end of the second Eisenhower Administration—helped to establish two new, but moderately funded, aid organizations—the Development Loan Fund (DLF), and the International Development Association (IDA), later incorporated into the World Bank. With an initial subscription of \$900 million, IDA provided concessionary development loans to low income countries.<sup>33</sup>

Over time, policymakers also began to acknowledge that financial capital, by itself, was insufficient to address the myriad of problems facing the developing world.<sup>34</sup> In this sense, the Marshall Plan proved inadequate as a model. In contrast to postwar Europe, where the major problem was one of reconstruction, the newly independent nations had to build social and economic institutions from scratch. U.S. policymakers soon came to realize that, if capital were to be used effectively in the developing countries, it would have to be linked to the transfer of technical and administrative knowledge and skills. At the same time, the United States initiated a major food assistance program, authorizing the sale of surplus grains to developing countries at prices below costs in return for local—and more often than not—inconvertible currencies.<sup>35</sup>

A major shift in U.S. foreign aid policy occurred in the early 1960s, with the advent of the Kennedy Administration. A long time advocate of foreign aid, Kennedy was the first President to make Third World economic development a prominent goal of U.S. foreign policy.<sup>36</sup> Speaking in Congress in 1959 in support of aid to India, Kennedy had—while still a Senator—equated the importance of the “economic gap” with that of the “missile gap.”<sup>37</sup>

<sup>31</sup> As described by Krueger and Ruttan, “Until World War II, growth was not a conscious policy objective even in most industrial countries. Insofar as some governments attempted consciously to stimulate economic growth, little or no systematic knowledge was available to guide their efforts.” Anne O. Krueger and Vernon W. Ruttan, “Development Thought and Development Assistance,” in Krueger and Ruttan, *op. cit.*, footnote 9, p. 13; and David A. Baldwin, *Economic Development and American Foreign Policy: 1943–1962* (Chicago, IL: University of Chicago Press, 1966).

<sup>32</sup> Krueger and Ruttan, *op. cit.*, footnote 9, p. 15.

<sup>33</sup> Cingranelli, *op. cit.*, footnote 27, p. 139.

<sup>34</sup> Krueger, *op. cit.*, footnote 11, p. 28.

<sup>35</sup> This program was established in the mid-1950s under the Agricultural Trade Development and Assistance Act (Public Law 480).

<sup>36</sup> Cingranelli, *op. cit.* footnote 27, 169.

<sup>37</sup> Rustow, *op. cit.*, footnote 2, p. 157.

Kennedy's speech to the Senate followed on the heels of a number of alarming incidents and events such as the crises in Suez and the Formosa Straits, as well as the roughing up of Vice President Nixon in Latin America. With the spread of military and political unrest beyond the Soviet bloc, Kennedy's arguments resonated in Congress and among the public. Also important in building the case for aid was the strong support of a number of prominent academics, who marshaled theoretical arguments to demonstrate how foreign aid might provide the necessary impetus for sustainable growth in the developing world.<sup>38</sup>

Building on this growing consensus, Kennedy increased funding for foreign assistance programs (most notably soft loans) early in his presidency. Equally, if not more important, he extended the goal of aid to include economic development as well as economic growth, while at the same time expanding the notion of what foreign aid programs should entail. To realize his vision of the "development decade," aid programs were to generate fundamental social and economic change in the developing world.<sup>39</sup> To this end, Kennedy established new and innovative programs such as the Peace Corps and the Alliance for Progress. In addition, in 1961, he highlighted the role of foreign aid, by bringing together and reorganizing programs within a new, independent agency—the U.S. Agency for International Development (USAID) (see box 2-1).<sup>40</sup> Enthusiasm for Third World economic development reverberated throughout the industrial world.<sup>41</sup> As Europeans recovered from the Second World War, they began to assume greater

responsibility for the financial and administrative burden associated with foreign assistance. Thus, although the United States had accounted for more than one-half of all foreign aid throughout the 1960s, by 1970, the real value of U.S. aid had dropped by one-fifth, constituting less than one-third of all aid flows.<sup>42</sup>

Equally impressive was the shift in the origins of aid. Although the Japanese had been major borrowers of World Bank funds throughout the 1960s, by the mid-1970s, they were major providers of concessionary aid, focusing their efforts for the most part in East Asia. West Germans also rose in rank to become the third largest donor among the OECD countries. In the wake of the 1973 oil embargo, the OPEC countries also became critical players in the world economy; serving also as major lenders. By 1975, the OPEC countries had increased their aid ninefold; most of this aid was destined for the Islamic world.<sup>43</sup>

New donors clearly had their own priorities, which were not always consistent with U.S. goals. Less concerned than the United States about communism, many pressed for economic development over national security goals. Included, for example, were the Netherlands, the United Kingdom, and France, with France also seeking to promote its own language and culture. The Swedes, for their part, not only opposed political and strategic aid; they were also among the first to call for projects that stressed Third World self-reliance and basic human needs. Other countries, such as West Germany and Japan, had economically oriented aid programs intended to promote trade and exports.<sup>44</sup>

<sup>38</sup> Describing his and his colleagues work at the time, Rustow notes, for example, "The central distinctive feature of our approach was that we placed economic growth and foreign aid systematically within the framework of the process of the modernization of societies as a whole." W.W. Rustow op. cit., footnote 2, pp. 43–54. See also Raymond F. Mikesell, Robert A. Kilmarx and M. Kramish, *The Economics of Foreign Aid and Self-Sustaining Development* (Boulder, CO: Westview Press, 1985), pp. 5–6.

<sup>39</sup> As Cingranelli notes, "Kennedy stated boldly for the first time that U.S. foreign policy should seek to affect not just the foreign policies of other nations, but their domestic affairs as well." Cingranelli, op. cit., footnote 27, p. 169.

<sup>40</sup> Robert E. Wood, *From Marshall Plan to Debt Crisis: Foreign Aid and Development Choices in the World Economy* (Berkeley, CA: University of California Press, 1986), p. 75.

<sup>41</sup> David Halloran Lunsdaine, *Moral Vision in International Politics: The Foreign Aid Regime 1949–1989* (Princeton, NJ: Princeton University Press, 1993), pp. 238–239.

<sup>42</sup> Browne, op. cit., footnote 20, p. 36.

<sup>43</sup> Ibid.

<sup>44</sup> Wood, op. cit., footnote 40.

### BOX 2-1: The U.S. Agency for International Development (USAID)

USAID is one of several federal agencies responsible for administering the international affairs budget of the United States. Established in 1961, USAID dispenses bilateral assistance to support its four sustainable development strategies of promoting broad-based economic growth, stabilizing world population, protecting the environment, and fostering democratic principles. USAID administered about one-third of the \$21.5 billion spent by the U.S. government on International Affairs in Fiscal Year 1995. The major USAID-administered programs and approximate budget figures are listed below.

	<b>1995 Estimate</b>	<b>1996 Request</b>
Development Assistance Fund	\$1,319,402,000	\$1,300,000,000
Development Fund for Africa	802,000,000	802,000,000
Microenterprise and Other Credit Programs	2,000,000	14,500,000
Housing Guaranty Program	27,300,000	24,000,000
International Disaster Assistance	169,998,000	200,000,000
Foreign Service Retirement and Disability	45,118,000	43,914,000
Operating Expenses	556,645,000	568,145,000
Subtotal: Development Assistance	<u>\$2,922,463,000</u>	<u>\$2,952,559,000</u>
Economic Support Fund	\$2,450,900,000	\$2,494,300,000
Assistance for Central and Eastern Europe	359,000,000	480,000,000
Assistance for the Newly Independent States	719,400,000	788,000,000
	<u>\$6,451,763,000</u>	<u>\$6,714,859,000</u>

Development Assistance activities are designed to promote sustainable development in some of the poorest countries in the world. The largest program in this category is the Development Assistance Fund which in FY 1995 made grants to developing country governments, nongovernmental organizations, and international agencies totaling approximately \$1.3 billion. Roughly one-third of this total was aimed specifically at stabilizing world population. The Development Fund for Africa was created in FY 1988 as a single development fund for sub-Saharan Africa, thereby giving USAID greater flexibility in meeting the region's development needs. Funds for Microenterprise and Other Credit Programs are used to guarantee market rate loans for small enterprises developments which further USAID's development agenda. The Housing Guaranty Program extends guaranties to U.S. private investors who make loans to developing countries to assist them in formulating and executing sound housing and community development policies that meet the needs of lower income groups.

The \$2.5 billion spent through the Economic Support Fund in FY 1995 included \$220 million for countries in transition such as Nicaragua, Haiti, and Cambodia and \$2.3 billion for promoting peace and economic development especially in Israel, the West Bank, Gaza, Egypt and Turkey. USAID also continued to support democratization in Central and Eastern Europe and the Newly Independent States of the Former Soviet Union begun in 1989 with passage of the Support for Eastern European Democracy Act and the Freedom Support Act.

SOURCE: Adapted from the Agency for International Development, Congressional Presentation, Fiscal Year 1996.

**FIGURE 2-2: Evolution of Multinatio**



SOURCE: David Halloran Lumsdaine, "Moral Vision in International Politics, The Foreign Policy Regime, 1949-1989" (Princeton, NJ: Princeton University Press),

Responsibility for foreign assistance was further diffused, as more and more aid was channeled through the many multilateral organizations that had proliferated and gained prominence throughout the 1960s (see figure 2-2). Thus, whereas in 1964, only 6 percent of U.S. aid was distributed via multinational organizations, by 1970, this figure had risen to 14 percent, and by 1975, it reached 35 percent. A parallel development occurred in other OECD countries, with multilateral aid totaling 6, 14, and 23 percent for the same years .45

One growing source of multilateral funding was the regional development banks. These banks were set up during the 1960s to increase funding to specific regions of the world. Modeled after the IBRD and IDA, they offered loans

to the developing countries both on a commercial and a concessionary basis.

International politics played an important role in the regional development banks' establishment. Initially, recipient countries lobbied hard on their behalf, while the United States consistently opposed them. The United States did not want to further dilute its control over the flow of aid. Nor was it eager for new development banks to compete with private lenders.<sup>46</sup> But eventually, and in each case, the U.S. Government was forced to acquiesce in the face of pressing international events. Thus, the InterAmerican Development Bank was set up in 1959 to discourage Latin American radicalism; the Asian Development Bank, in 1965 to offset military activities in Vietnam; and the African Development Bank, in

45 Rustow, *op. cit.*, footnote 2, p. 179.  
 46 Wood, *op. cit.*, footnote 40.

1974 to foster better relationships with the black African states.

As a major donor, the United States was able to exercise considerable leverage.<sup>47</sup> Most important from a long term perspective, it steered the bank's loan policies so as to foster Western economic and political principles throughout the developing world. Moreover, when critical U.S. interests were at stake, U.S. bank officials were generally able to influence loan decisions to promote a more specific or immediate foreign policy goal.<sup>48</sup>

U.S. influence was less pronounced in the Development Assistance Committee (DAC) of the OECD, a second major source of multilateral assistance. Set up in 1963, the DAC aimed to coordinate the growing number of bilateral development programs that had evolved in parallel with USAID. Created at the high tide of the "development decade," the DAC was a clarion for foreign assistance. Given its own professional staff with the power to monitor, collect statistics, and set standards, the DAC strongly influenced international aid policy and distribution.<sup>49</sup> By setting higher and higher targets, the DAC generated greater quantities of aid. However, by focusing on the moral obligation to provide aid, the DAC failed to sufficiently debate and develop a more comprehensive and enduring foreign assistance rationale.<sup>50</sup>

Developing countries also came to play an increasingly important role in promoting aid, with the United Nations (U.N.) providing the major forum for articulating their needs. Unlike the multilateral developing banks—where voting is weighted—in the U.N. General Assembly all

parties have an equal voice. Comprising approximately two-thirds of U.N. members in 1960, the Third World was not to be ignored. Proclaiming the 1960s as the First U.N. Development Decade, developing countries set an aid target totaling 1 percent of the combined incomes of the industrialized world. In the next four years, a number of new aid programs were introduced, and the amount of aid that was channeled through them quadrupled.<sup>51</sup>

The developing countries seemed to thrive in this expanded aid environment. In particular, the East Asian countries such as Taiwan, Hong Kong, Korea and Singapore took advantage of the opportunity to propel their economies beyond the stage of "take-off" for sustainable economic growth.<sup>52</sup> Even the poorest countries, however, appeared to do well, achieving growth rates above their norms. India, for example, experienced growth in gross domestic per capital income of 1.5 percent. Although low in comparison with many other developing countries during this era, India's growth rate in the 1970s was more than three times higher than it had been the century before.<sup>53</sup>

For some countries, these economic gains were illusory. When later put to the test in a contracting international economic environment, these economies could not sustain their growth. To the contrary, many governments continued to borrow to keep their growth rates high. However, such policies were ultimately self-defeating, plunging many developing countries yet deeper and deeper into debt.

For the United States, the record of this period was also mixed. The massive growth in multilateral support for foreign assistance helped to

<sup>47</sup> Organized along the lines of a joint stock company, the multinational banks use a system of weighted voting, which gave major donors such as the United States a predominant voice. The United States also held the positions of president of the World Bank and executive vice-president of the International Development Bank, which oversees concessionary funding. *Ibid.*, p. 8.

<sup>48</sup> Jonathan E. Sanford, *Foreign Policy and Multilateral Development Banks* (Boulder CO: Westview Press, 1982), pp. 39–40.

<sup>49</sup> The original members included the six established donors—the United States, France, the United Kingdom, the Netherlands, Belgium, and Portugal as well as four newer donors, West Germany, Japan, Italy, and Canada. Lunsdaine, *op. cit.*, footnote 41, p. 246.

<sup>50</sup> Browne, *op. cit.*, footnote 20, p. 24.

<sup>51</sup> Included among these programs were the capital funded Special U.N. Fund for Economic Development (SUNFED), which when later was consolidated with EPTA became the U.N. Development Fund, The World Food Program, created by the UN Food and Agricultural Organization in 1963; the U.N. Development Organization (UNIDO) set up in 1967; and the World Employment Program, begun by the International Labor Organization (ILO) in 1969.

<sup>52</sup> The concept of "takeoff" was developed by W.W. Rustow as part of his model of the evolutionary process leading to nonreversible economic development. See W.W. Rustow, *The Stages of Economic Growth* (Cambridge, UK: Cambridge University Press, 1960).

<sup>53</sup> Krueger, *op. cit.*, footnote 11, p. 13.

reduce the heavy financial and administrative burden that the United States assumed at the end of the Second World War. At the same time, however, the entry of new participants made it harder for the United States to use aid for its own foreign policy purposes. Eventually, this lack of control served to undermine domestic support for aid. As the decade wore on, U.S. aid representatives were increasingly chastised by Congress for failing to adequately protect U.S. interests.<sup>54</sup>

### ■ Disappointment and Retrenchment

The public and congressional enthusiasm that accompanied Kennedy's foreign aid initiative was short-lived. Already by 1963, funding for U.S. foreign assistance began to dwindle, and it continued on a downward slope for more than a decade (see figure 2-3).<sup>55</sup> Public enthusiasm for foreign assistance was also on the wane. In a poll taken in 1980, more than eighty percent of the respondents favored a cutback in all foreign aid.<sup>56</sup> Many factors accounted for this growing disillusionment. Included, for example, were a crisis in the world economy, which led to greater preoccupation with domestic affairs; the growing importance of private capital flows as a substitute for aid; failed expectations and a loss of confidence in aid policies; as well as emerging North-South tensions.

Living up to the expectations of the 1960s would have been difficult in any event. It proved to be impossible, however, in the radically changed international and domestic environment characterizing the 1970s and 1980s. Nothing confirmed this transformation more than the 1973 OPEC oil embargo and the rising price of oil. Prior to the first hike in oil prices, industrialized countries had a current account surplus of about 1 percent of GNP, while the developing countries had an equivalent modest deficit of 1

percent. Within a year, the situation changed radically. Industrialized countries had lost their surplus, and many developing countries had doubled their deficits.<sup>57</sup>

The second oil price increase, in 1979, was even more devastating, creating balance of payments problems for industrialized countries, as well. In the United States, these problems were compounded by the drain on the economy due to the protracted Vietnam War. The result was a long period of stagflation characterized by both high prices and minimal growth, leading to increased protectionism and a decline in the demand for Third World imports. Thus, the volume of world trade grew only 1.5 percent in 1980; was virtually nil in 1981; and dropped 3.2 percent in 1982. Although the volume of world trade increased in 1983 by 2 percent, its value fell proportionately.<sup>58</sup>

Faced with their own economic problems, industrialized countries could not meet the developing countries' growing capital needs. In the United States, for example, President Nixon called increasingly on the private sector to fill this financial gap. To this end, the Nixon Administration created the Overseas Private Investment Corporation (OPIC), which provided government insurance for private investments in developing countries (see box 2-2).

With "petrodollars to spare," Western banks eagerly took up the slack. Developing countries appeared a good investment.<sup>59</sup> Moreover, so long as interest rates remained fixed and inflation was on the rise, these countries could borrow without increasing their debt-service ratios. And, borrow they did. In the years between 1970 and 1980, private lending by commercial banks increased in real terms from \$9 billion to \$47 billion. And the proportion of total net financial

<sup>54</sup> Jonathan E. Sanford, op. cit., footnote 48, pp. 182–183.

<sup>55</sup> Krueger, op. cit., footnote 11, p. 30.

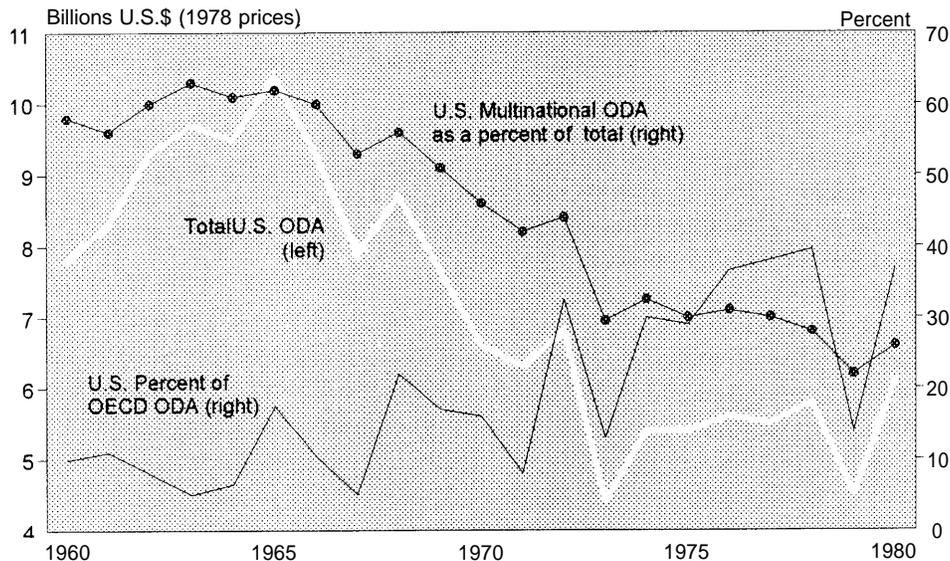
<sup>56</sup> Robert E. Wood, op. cit., footnote 40, p. 1.

<sup>57</sup> Browne, op. cit., footnote 20, p. 31.

<sup>58</sup> Raul L. Madrid, *Overexposed: U.S. Banks Confront the Third World Debt Crisis* (Boulder CO: Westview Press, 1992), p. 73.

<sup>59</sup> Gilpin, op. cit., footnote 22, p. 318 and Wood, op. cit., footnote 40, p. 243.

FIGURE 2-3: U.S. Official Development Assistance, 1960–80.



SOURCE: World Development Report 1981 (World Bank) Table 6, p. 164-165 as cited in W.W. Rostow, *Eisenhower, Kennedy, and Foreign Aid* (Austin, TX: University of Texas Press, 1985).

### BOX 2-2: The Overseas Private Investment Corporation (OPIC)

Since beginning operations in 1971, OPIC has been the key U.S. government agency encouraging American private business investment in developing countries. It encourages investment by providing project financing and political risk insurance to ventures with significant equity or management participation by U.S. companies. OPIC provides these ventures with direct loans and loan guarantees that provide medium to long-term funding and look for repayment from project revenues. Political risk insurance is used by recipients to insure against expropriation of assets, currency inconvertibility, political violence and other forms of investment exposure. OPIC also supports a small number of privately managed investment funds that target emerging markets around the world and provides other investor services including seminars and conferences throughout the United States, investment missions and reverse missions.

From FY 1988 through FY 1993, OPIC provided \$434,030,732 in political risk insurance and \$195,650,000 in financing through direct loans and/or loan guarantees to developing countries.

SOURCE: OPIC 1994 Annual Report and "U.S. Government, Private Sector, NonProfit, and Academic Contributions to Communications Development," Information Infrastructure Task Force, March 1994.

receipts that constituted aid fell from 60 to 30 percent in the years between 1960 and 1980.<sup>60</sup>

This situation was untenable over the long run, however. The onset of a worldwide recession

in 1980, accompanied by a shift to floating exchange rates, reduced the demand for developing country exports, forcing them to borrow again and again to finance their current account

<sup>60</sup> Anne O. Krueger and Vernon W. Ruttan, in Krueger, Michalopoulos, and Ruttan op. cit., "Toward a Theory of Development Assistance," footnote 9, chap. 3, p. 37.

deficits. This time, however, worldwide interest rates were much higher, so debt service costs were no longer in their favor. The result was the debt crisis of 1982, discussed below.

With developing countries no better off than a decade earlier, many began to question the value of aid. Criticism abounded, coming from all quarters. Conservatives and radicals alike opposed the foreign aid regime not simply because it was ineffective, but rather—and much more significantly—because it was considered to be detrimental to economic development goals.<sup>61</sup>

Citing the long history of Western progress, conservative critics emphasized that economic development did not require economic aid. To the contrary, economic growth—as they pointed out—had occurred only in situations where markets were free and open, and where cultures were supportive of individualistic, entrepreneurial norms. Aid, they argued, could only stunt economic development. Foreign capital, when provided as aid, was likely to substitute for, rather than to encourage, domestic savings. Moreover, when distributed to those in power, aid was likely to be used to promote government controls and to perpetuate corrupt and inefficient business practices.<sup>62</sup>

Like the conservatives, the critics on the left also believed that the long run consequences of foreign aid were negative.<sup>63</sup> They argued that, if anything, aid served only to widen the gap between the rich and the poor. Rarely, if ever, had aid benefited the people most in need. Instead, it had been used primarily to bolster the

positions of those in power.<sup>64</sup> Donors, these critics claimed, were equally at fault, aligning themselves with elites in developing countries so as to achieve their own political and economic objectives.<sup>65</sup> From this radical perspective, what was needed to assure that aid served the poor was nothing less than a total redistribution of political power.

This debate over the merits of aid raised fundamental questions about the nature of economic development itself. The result was a major shift in the direction of foreign assistance programs. Economic development was no longer viewed as a problem of increasing capital inputs so as to generate greater national output. Instead, it was conceived as a problem of reducing poverty and providing for peoples' basic needs.<sup>66</sup> Accordingly, aid programs were redesigned to focus less on infrastructure development and more on income redistribution. The oil embargo had also made people more conscious of the need to conserve natural resources. Increasingly, aid programs sought to take into account the effect of economic and population growth on environmentally sustainable development.

Reflecting this shift in priorities, the Congress passed the Foreign Assistance Act (referred to as the Basic Human Needs Mandate or New Directions) in 1973. This legislation called for a new aid strategy to help poor people in the Third World improve their food production, health care, nutrition, population planning, and educa-

<sup>61</sup> Roger C. Riddell, *Foreign Aid Reconsidered*, op.cit., footnote 9; See also Paul Mosley, *Foreign Aid: Its Defense and Reform* (Lexington, KY: The University of Kentucky, 1987).

<sup>62</sup> Ibid.

<sup>63</sup> Ibid., pp. 129–156.

<sup>64</sup> F. M. Lappe, J. Collins, and D. Kinley, *Aid as Obstacle: Twenty Questions About Our Foreign Aid and the Hungry* (San Francisco, CA: Institute for Food and Development Policy, 1980).

<sup>65</sup> As described by Carty and Smith, “Underdevelopment... didn’t just ‘happen’—nor is it a problem solely generated within the Third World. External forces have substantially created it. In every situation of underdevelopment, there are *underdevelopers*—structures, powers, and governments which ride the backs of the southern nations and choke off their development possibilities.” R. Carty and V. Smith, *Perpetuating Poverty—The Political Economy of Canadian Foreign Aid* (Toronto, Canada: Between the Lines, 1981), p. 11, as cited in Riddell, op. cit., footnote 9, p. 134.

<sup>66</sup> The basic needs approach was first laid out by the Director-General of the International Labor Organization (ILO), in March 1976 during a speech to the World Employment Conference. See *Employment, Growth, and Basic Needs: A One World Problem* (Geneva, Switzerland: The International Labor Office, 1976), p. 31; see also Robert L. Curry Jr., “The Basic Needs Strategy, the Congressional Mandate, and U.S. Foreign Aid Policy,” *Journal of Economic Issues*, vol. 23, No. 4, 1989, pp. 1085–1096.

tion.<sup>67</sup> Five years later, in 1978, Congress reaffirmed that the principal purpose of U.S. bilateral aid was to support equitable growth, so that the world's impoverished people could "satisfy their basic needs and lead lives of decency, dignity, and hope."<sup>68</sup>

This new congressional mandate coincided with, and was reinforced by, the Carter Administration's foreign policy efforts to protect human rights and improve North/South relations. Foreign aid was central to this effort. The provision or denial of aid was often used to induce developing countries to respect human rights. Thus, notwithstanding the overall downward trend in funding, expenditures on foreign aid increased from \$4 billion in 1976 to \$7 billion in 1980 during President Carter's tenure.<sup>69</sup>

Parallel changes were also taking place in the international arena. In the 1970s, the World Bank restructured its lending programs around a three-pronged approach. First, foreign assistance was redirected to the 25 most impoverished countries.<sup>70</sup> Many of these—located in Africa—had previously received only a small proportion of aid. Second, funds were shifted from large scale, growth-oriented infrastructure projects to more general programs designed to meet human needs and provide purchasing power to the poor. Finally, funding was set aside for direct intervention to alleviate poverty.<sup>71</sup>

Although the basic needs approach helped to bring problems of poverty, rural areas, and equity to the fore, it was limited in a number of ways. One difficulty, which soon became obvious, was defining poverty and determining basic

needs. Generalizing was problematic, because peoples' "needs" are highly contextual. Locating the poor and gaining the support of local elites also proved difficult.<sup>72</sup>

From the long-term perspective, the most serious problem was the inclination to downplay—and in some cases even denigrate—the need for economic growth.<sup>73</sup> Proponents argued that growth policies, which rely on "trickle-down" benefits, are unlikely to serve the poor.<sup>74</sup> What they failed to take into account, however, is that without growth, developing countries will not have sufficient resources to provide for basic needs. Moreover, when resources are channeled for present consumption rather than for investments for the future, later generations may be at risk.<sup>75</sup>

Significantly, those countries that deliberately pursued growth-oriented development policies far outperformed those that did not. Most successful in this regard were the East Asian countries—Korea, Taiwan, Singapore, and Hong Kong, which developed highly successful export-oriented growth strategies. Between 1960 and 1989, for example, these countries increased their exports from \$2 billion (which constituted 5 percent of all developing country exports) to \$246 billion (or 32 percent of all developing countries' exports).<sup>76</sup> This export growth not only served to prime the newly industrializing countries' (NICs) domestic economies; it also provided the foreign exchange necessary to survive the subsequent downturn in the global economy.<sup>77</sup>

The basic needs approach posed problems not only for aid recipients but for aid donors as well,

<sup>67</sup> Mark F. McGuire and Vernon W. Ruttan, "Lost Directions: U.S. Foreign Assistance Policy Since New Directions," *The Journal of Developing Areas*, vol. 24, January 1990, pp. 127–180.

<sup>68</sup> *Ibid.*

<sup>69</sup> Rustow, *op. cit.*, footnote 2, p. 185.

<sup>70</sup> Countries in poverty were designated in 1973, using criteria such as income per capita, literacy rates, manufacturing capabilities, etc. A decade later, the number of countries in this category had actually increased. Browne, *op. cit.*, footnote 20, pp. 116–117.

<sup>71</sup> *Ibid.*

<sup>72</sup> Robert Ayres, *Banking on the Poor: The World Bank and World Poverty* (Cambridge, Mass. MIT Press, 1983), pp. 102–103.

<sup>73</sup> Sidney Dell, "Development Objectives: Basic Needs or Comprehensive Development," in Sidney Dell, *International Development Policies: Perspectives for Industrialized Countries* (Durham, NC: Duke University Press, 1991).

<sup>74</sup> Judith Tendler, *Rural Projects Through Urban Eyes: An Interpretation of the World Bank New Style Rural Development Projects*, World Bank, Working Paper, No. 532, 1982, p. 3.

<sup>75</sup> Dell, *op. cit.*, footnote 73.

<sup>76</sup> Krueger, *op. cit.*, footnote 11, p. 105.

<sup>77</sup> Stanley Fischer and Ishrat Husain, "Managing the Debt Crisis in the 1990s," *Finance and Development*, June 1990, p. 24.

making it hard for them to design, evaluate, and/or influence project outcomes.<sup>78</sup> Because aid was distributed to alleviate poverty, donors were unable to channel foreign assistance to countries that—given their policies and resources—could use it most effectively. In addition, when aid programs were oriented towards general programs rather than specific projects, donors had less control and fewer opportunities to work cooperatively with recipient countries, sharing knowledge and information in a two-way fashion.

Given its focus on poverty and program flexibility, the basic needs approach was intended to improve relations with the Third World. However, instead of ameliorating North/South tensions, foreign aid—and the related issue of the developing countries' role in the world economy—became a major source of contention. Far from being pleased with the new aid regime, developing countries complained that aid donors did not go far enough in meeting their needs.

To rectify the situation, Third World countries called for a new international economic order, which—based on a wide range of institutional reforms—would give them greater power and control over their own fates. In late 1974, these objectives were incorporated into the “U.N. Charter of Economic Rights and Duties of States,” in keeping with a vote of the General Assembly, where the developing countries—known as the Group of 77—had a solid majority.<sup>79</sup>

Unwilling to renounce their authority and freedom of action, donor countries strongly resisted such changes.<sup>80</sup> While maintaining a dialogue with the Group of 77, donor countries were increasingly irritated by, and unreceptive

to, their demands. This growing antagonism was only partially assuaged when the U.N. proclaimed the 1980s the “Third Development Decade.”<sup>81</sup>

Thus, the basic needs approach also failed to alleviate political tensions between industrialized and developing countries. To the contrary, U.S. interactions with the Third World deteriorated. The “Second Development Decade,” which had begun inauspiciously with the oil embargo of 1973, closed in a resounding finale with the Iranian Revolution of 1979.

This deteriorating international political situation helps account for the abrupt shift in U.S. foreign aid policy that occurred at the end of the seventies. On entering office, President Carter strongly advocated the basic needs approach. However, by the end of his term, the Carter Administration was redirecting its foreign assistance programs to U.S. security needs. In 1979, the Administration's overall appropriation bill allocated \$1.91 billion for security support assistance but only \$1.3 billion to economic development. To facilitate this shift in focus, aid funding was increasingly drawn from the Economic Support Fund (ESF) account, which—being totally fungible—could rapidly be dispersed for any politically expedient purpose.<sup>82</sup>

The Reagan Administration went even further in moving away from a basic needs approach to one focusing on security-related foreign assistance. Early on, the Acting Assistant Secretary of State for African Affairs announced that foreign assistance would increasingly “emphasize areas of strategic and political priority to the U.S.,” as well as rely heavily on the ESF, which “provides flexible resources necessary to carry forward our

<sup>78</sup> Krueger, et al., op. cit., footnote 9.

<sup>79</sup> These demands were made at a special session of the U.N. General Assembly held in early 1974. At the end of the year, they were incorporated into the U.N. Charter of Economic Rights and Duties of States. They included the rights to 1) form producer associations; 2) link commodity export prices to the prices of manufacturing goods exported from the industrialized world; 3) nationalize foreign enterprises and domestic control of natural resources; and 4) establish rules and regulations for multinational corporations located within their borders. Gilpin, op.cit., footnote 22, p. 298; See also Steven Krasner, *Structural Conflict: The Third World Against Global Liberalism* (Berkeley, CA: The University of California Press, 1985).

<sup>80</sup> Wood, op. cit., footnote 40, p. 113.

<sup>81</sup> Rustow, op. cit., footnote 2, p. 230.

<sup>82</sup> McGuire and Ruttan, op. cit., footnote 67, p. 128.

U.S. policies in nations affected by rapidly changing economic and security problems.”<sup>83</sup>

The ultimate—and perhaps inevitable—breakdown in the international aid regime did not occur, however, until August 1982, when the Mexican government announced that, without assistance, it could not service its foreign debt. Within two years, no fewer than 42 additional countries—with outstanding foreign debts totaling \$27 billion—followed suit.<sup>84</sup> The Reagan Administration had little choice but to intervene. American banks held a major portion of the less developed countries (LDC) debt, so their very existence was at stake. The claims held by the nine largest U.S. banks against Argentina, Brazil, and Mexico constituted more than 135 percent of their total capital.<sup>85</sup>

### ■ From Debt Crisis to Structural Adjustment

The LDC debt crisis not only marked the end of the old aid regime. Equally important, its mode of resolution became the model, and modus operandi, for the aid regime to follow. Foreign aid was henceforth no longer viewed as the key to economic growth. Much more critical was the role that developing countries could themselves play in restructuring their economies in accordance with market principles. Most policymakers agreed that, in the post-debt-crisis environment, aid might best be used not to promote growth per se, but rather to induce structural economic adjustments to foster growth and facilitate the developing countries’ integration into the global economy.

The debt crisis served to winnow Third World winners from losers. The few countries that pur-

sued growth strategies based on austerity and export promotion survived the upheavals of the seventies with their economies intact. On the other hand, most developing countries borrowed heavily throughout this period. And instead of investing in development projects, they used these funds to cover growing trade imbalances and debt servicing requirements. Their growth rates fell as a result, compounding their liquidity problems and further stifling their development.<sup>86</sup>

Given such fundamentally different economic outcomes, private investors and foreign aid providers alike began to examine how policies in recipient countries might affect economic development prospects. Comparing experiences, they concluded that developing countries’ problems stemmed from their own economic policies, which distorted market signals, misallocated resources, and discouraged efficient production and investment. For growth to occur, the developing countries—they contended—had to restructure their economies according to free market principles.<sup>87</sup> Foreign banks holding developing countries’ loans agreed with this assessment, which served to justify their firm stance in setting up rescheduling terms.<sup>88</sup>

Given no alternative sources of funding and little bargaining power, debtor countries rapidly acceded to the banks’ seemingly harsh demands. In exchange for rescheduling of their debts, developing countries agreed to reduce domestic demand for both imports and exports by curtailing budget deficits, reducing real wages, and devaluating their currencies.<sup>89</sup>

The multinational banks played a major role in the rescheduling negotiations. Public lenders increased their disbursements to the 17 most

<sup>83</sup> As cited in Robert L. Curry, Jr., footnote 66, p. 1092.

<sup>84</sup> Raul L. Madrid, *op. cit.*, footnote 58.

<sup>85</sup> Benjamin J. Cohen, “What Ever Happened to the LDC Debt Crisis?” *Challenge*, May/June 1991, p. 48. Argentina, Brazil, and Mexico alone owed about \$260 billion, which constituted 40 percent of the total Latin American debt.

<sup>86</sup> Madrid, *op. cit.*, footnote 58, p. 73.

<sup>87</sup> For one discussion, see Anne O. Krueger, *Economic Policy Reform in Developing Countries* (Cambridge, MA: Blackwell, 1992).

<sup>88</sup> The developing countries were not alone, however, in failing to foresee the dire consequences of such heavy borrowing. Despite numerous warning signals about the deteriorated state of the developing economies, U.S. banks assiduously cultivated relationships with Third World political and business leaders, hoping to outbid one another for these highly lucrative loans. Moreover, U.S. and other foreign banks accumulated these mounting credit obligations with the blessings of the governments of the industrialized countries. Madrid, footnote 58, *op. cit.*; and Dell, *op. cit.*, footnote 73, p. 136.

<sup>89</sup> Dell, *op. cit.*, footnote 73, p. 144.

debt-troubled countries from \$3.7 billion in 1981 to \$5.5 billion in 1983. By 1985, funding totaled \$6.3 billion.<sup>90</sup> Without this increased support, debtor countries would have been unable to refinance their loans. The multilateral banks also legitimized the rescheduling process. Banks generally looked to the IMF to approve a debtor country's austerity program. In fact, in some cases, they refused to enter into discussions with debtor countries until the multinational lenders had given their approval.<sup>91</sup>

These debt scheduling agreements proved, however, to be unenforceable. Given the imposed austerity programs, Third World economies went into reverse. Thus, for example, the GDP of many Latin American countries fell during the period from 1981 to 1985, as did income and per capita consumption.<sup>92</sup> Low growth rates meant, moreover, that debtor countries were once again in arrears. By the late 1980s, some countries stopped making their interest payments, while others insisted on gaining greater bank concessions.<sup>93</sup>

Acknowledging the gravity of the situation, the U.S. government sought to reduce the developing countries' debt burden. In October 1985, Secretary of the Treasury James Baker announced a plan (subsequently referred to as the Baker Plan) that called for a more broadly based and equal sharing of the debt burden. Although far more generous than the previous commercial

bank agreements, the Baker Plan entailed the same quid pro quo—additional funding in exchange for trade liberalization, privatization, and greater market reform.<sup>94</sup>

While moving in the right direction, the Baker Plan did not go far enough. Instead of improving, developing country economies either stagnated or experienced decline.<sup>95</sup> Between 1981 and 1987, for example, the real gross domestic product (GDP) of the most indebted countries was less than the average growth rate of the previous decade, and in 1987 their per capita GDP fell to almost 6 percent below the 1980 level.<sup>96</sup> Declining growth was, moreover, accompanied by declining gross investment. As commercial banks became more cautious in their lending policies, and domestic investors increasingly hoarded financial assets abroad, gross capital formation in the most heavily indebted countries dropped from 24 to 17 percent in the period between 1981 and 1987.<sup>97</sup>

A new approach was clearly in order. Thus, in March 1987, Treasury Secretary Nicholas Brady proposed a new plan—the Brady Plan, which provided permanent debt relief and debt service reduction in exchange for greater economic reform.<sup>98</sup> Being market driven, the Brady Plan gave commercial banks a chance to exchange

<sup>90</sup> Ibid.

<sup>91</sup> Ibid. Equally critical for debt rescheduling was the continued export credits and development grants provided by the industrialized countries to the Third World. The Paris Club Creditors—as the participating countries were called—also provided debt service relief by rescheduling payments on their previous medium and long term credits to the developing countries. In contrast to the commercial banks, the Paris Club creditors were at times also willing to reschedule interest payments.

<sup>92</sup> Michael P. Dooley, *A Retrospective on the Debt Crisis*, Working Paper No. 4963 (Cambridge, MA: National Bureau of Economic Research, 1994), pp. 23–24.

<sup>93</sup> The debtor countries attributed the stagnation of their economies to the austerity programs prescribed by the IMF, while the banks claimed that the developing countries had not extended their reforms far enough to reap the benefits. By 1985, growing discontent threatened to undermine political stability in many Third World countries.

<sup>94</sup> In accordance with the plan, commercial banks would make \$20 billion available to the poorest 15 debtor countries within the subsequent three years, during which time multilateral banks would provide an additional \$9 billion. For their part, the creditor nations would stimulate their economies and reduce their barriers to Third World imports.

<sup>95</sup> John Endowed, "The World Bank's Response to the Developing Country Debt Crisis," *Contemporary Policy Issues*, vol. 7, April 1989, p. 57.

<sup>96</sup> Norman S. Fieleke, "Economic Adjustment in Heavily Indebted Developing Countries," *Contemporary Policy Issues*, April 1990, p. 19.

<sup>97</sup> Ibid. See also John Clark, "Debt Reduction and Market Reentry Under the Brady Plan," *Federal Reserve Bank of New York Quarterly Review*, winter, 1993/94, p. 39.

<sup>98</sup> Moreover, in contrast with previous plans, which pitted debtor and creditors against one another, the Brady plan was intended to foster cooperation. Offering a menu of options, the plan was also flexible enough to allow for diverse situations in debtor nations.

their developing country loans for government issued “Brady bonds.”<sup>99</sup>

Once again, the multinational lending institutions reinforced the notion of a quid pro quo, making aid contingent on major economic reforms. The IMF and the World Bank not only made reform a condition of lending, they also instituted special types of loans and arrangements—such as the structural adjustment loan (SAL)—to assist developing countries in carrying out the process.<sup>100</sup> Working together, the World Bank and the IMF advised developing countries and designed comprehensive economic reform packages for them.<sup>101</sup>

Many Third World countries were quick to embrace the concept of structural reforms.<sup>102</sup> Faced with dismal growth rates, continual debt, and the failure of state-directed development programs, they required a new development model. Thus, one by one, developing countries renounced the state-directed, import substitution growth strategies—so tenaciously pursued since the end of World War II—in favor of market reforms and export driven growth.<sup>103</sup> Although there were no pat formulas, most programs incor-

porated four basic elements—stabilization, liberalization, deregulation, and privatization.<sup>104</sup> Together, these measures were intended to create a market environment conducive to growth (see box 2-3).

Despite their popularity, economic reform programs have not improved the situation in many developing countries. Despite a few major success stories, overall results have been disappointing, especially in low income countries.<sup>105</sup> As can be seen in table 2-2, it is difficult to distinguish between the performance of those countries undertaking reforms and those that did not. Of the 55 developing countries that pursued such programs in the period between 1980 and 1988, only seven benefited across the board from greater stabilization, the restoration of growth, and a reduction in poverty. Twenty-seven of the 55 countries experienced negative growth in per capita income, while another 13 failed to reduce their external debt to a sustainable level.

Convinced of the general need for reform, economic development experts have studied and compared these cases in an effort to identify the factors that account for success. To date, most

<sup>99</sup> These bonds were lower in value and had a longer term of maturity, so their purchase entailed a partial write-off of the banks' claims. Many banks were willing to accept this loss, however, because the Brady bonds were backed by treasury securities as collateral. Debtor countries, for their part, benefited from lower principals and better terms. To participate in the plan, the developing countries had to purchase treasury securities as collateral against the principal and interest on a portion of their debt, as well as adopt even greater economic reforms.

<sup>100</sup> See Azizur Rahman Khan, *Structural Adjustment and Income Distribution: Issues and Experience* (Geneva, Switzerland, International Labor Office, 1993), p. 33.

<sup>101</sup> For a discussion of the need for structural reforms, see Anne O. Krueger, “Lessons From Developing Countries About Economic Policy,” *The American Economist*, vol. 38, spring 1994; For a summary and discussion of the empirical and theoretical literature, see Dani Rodrick, *Trade and Industrial Reform in Developing Countries: A Review of Recent Theory and Evidence* (Cambridge, MA: National Bureau of Economic Research, Inc. 1993).

<sup>102</sup> G. John Ikenberry, “The International Spread of Privatization Policies: Inducements, Learning and ‘Policy Bandwagoning,’” in Ezra N. Suleiman and John Waterbury (eds.), *The Political Economy of Public Sector Reform and Privatization* (Boulder, CO: Westview Press, 1990), chap. 4.

<sup>103</sup> Not surprisingly, therefore, between 1980 and 1991, 76 Third World countries received World Bank SALs. And by 1991, close to half of these countries had already carried out the reforms associated with more than one SAL agreement, while 19 had implemented five or more such agreements. Kahn, op. cit., footnote 100, p. 33.

<sup>104</sup> Lawrence H. Summers and L.H. Pritchett, “The Structural Adjustment Debate,” *Economic Development: Recent Lessons*, AEP Papers and Proceeding, May 1993, pp. 383-389. See also Ulrich Hiemenz and Norbert Funke, “The Experience of Developing Countries With Macroeconomic Stabilization and Structural Adjustment,” in Chung H. Lee and Helmut Reisen (eds.), *From Reform to Growth: China and Other Countries in Transition in Asia and Central and Eastern Europe* (Paris, France: OECD, 1994), p. 79.

<sup>105</sup> According to one analysis, growth in middle income countries increased from 2.1 percent to 4.8 percent per year in the period between 1981 to 1990, while in low income countries it only increased from 1.2 percent to 3.6 percent. During the same time, annual growth rates for exports increased in middle income countries from 26 to 34 percent, but increased by only one percentage point in poor countries, from 22 to 23 percent. Kahn, op. cit., footnote 100.

## BOX 2-3: Economic Reform Measures

Stabilization programs were designed to bring inflation under control by contracting the economy.<sup>1</sup> A stable currency is required to encourage savings and investment, and to allow the market to provide accurate information. Stabilization can be brought about by devaluing exchange rates, reducing current account and fiscal deficits, and by tightening the money supply. Although necessary for the effective functioning of the economy, these types of measures can dampen economic activity. Thus, they work best when counterbalanced by structural adjustment efforts that are designed to foster growth.

Structural adjustment measures—such as trade liberalization, deregulation, and privatization—shift economic activities from the public to the private sector.<sup>2</sup> They can generate growth by increasing the productivity of existing resources and by channeling them into more efficient usage. Trade liberalization, for example, is designed to heighten domestic competition and to create greater incentives for governments and firms to allocate national resources on a more efficient and global basis.<sup>3</sup> Similarly, deregulation and privatization measures are intended to enhance efficiency by reducing unproductive government rent seeking, improving the productivity of public investment, freeing up credit and inducing savings, and eliminating price distortions. If designed and timed correctly, structural adjustment measures can help to offset some of the negative growth impacts associated with stabilization.

<sup>1</sup> See, for a discussion, Sebastian Edwards, “The Political Economy of Inflation and Stabilization in Developing Countries,” *Economic Development and Cultural Change*, 1994, pp. 235–266.

<sup>2</sup> Ira W. Liberman, “Privatization: The Theme of the 1990s: An Overview,” *The Columbia Journal of World Business*, spring 1993, p. 11

<sup>3</sup> See, for a discussion, Jim Love, “Engines of Growth—The Export and Government Sectors,” *World Economy*, vol. 17, March 1994, pp. 203–218.

SOURCE: Office of Technology Assessment, 1995.

agree that constancy and commitment to reform are the key.<sup>106</sup> There is, however, considerable disagreement about how best to develop and sustain this commitment. At issue is the timing and sequencing of events.<sup>107</sup>

Pointing to successful development strategies pursued by many Asian countries, some believe it best to introduce reforms gradually and in a certain sequence, starting with microeconomic structural reforms, followed by stabilization and trade liberalization.<sup>108</sup> Citing the case of China, they claim that structural reforms generate

growth, new economic opportunities, and new winners with a stake in maintaining reform. If such benefits are sufficiently widespread, they argue, early structural reforms can legitimate a government’s efforts and help to develop a broader base of support for them.<sup>109</sup>

Gradualists also stress the need to begin by privatizing and introducing competition into sectors—such as agriculture and consumer goods—that do not compete with state owned enterprises (SOEs). As productivity increases in sectors such as agriculture, they argue, private investment and new jobs will gradually emerge at the fringe of

<sup>106</sup> Ulrich Heimez and Norbert Funke, “The Experience of Developing Countries With Macroeconomic Stabilization and Structural Adjustment,” in OECD, *From Reform to Growth*, op. cit., footnote 104, p. 79. See also Summers and Pritchett, op. cit., footnote 104.

<sup>107</sup> R. McKinnon, *The Order of Economic Liberalization: Financial Control in the Transition to a Market Economy* (Baltimore, MD: Johns Hopkins Press, 1991); see also Heimez and Funke, op. cit., footnote 106, pp. 79–89.

<sup>108</sup> Barry Naughton, “Reforming a Planned Economy: Is China Unique?” in OECD, *From Reform to Growth*, op. cit., footnote, 104, pp. 49–71; see also Pradumna B. Rana and Wilhelmina Paz, “Economies in Transition,” in OECD, op. cit., footnote 104.

<sup>109</sup> Naughton, op.cit. footnote 108. For a discussion of the importance of legitimacy in maintaining regimes, see Juan J. Linz and Alfred Stephan (eds.), *The Breakdown of Democratic Regimes* (Baltimore, MD: Johns Hopkins University Press, 1978).

TABLE 2-2: Relative Performance of Adjusting and Nonadjusting Countries

Indicator	Adjusting countries <sup>1</sup>	Nonadjusting countries <sup>2</sup>																								
1. Growth in per capita GDP between 1980 & 1989	27 of the 55 countries had negative rates of growth.	16 of the 31 countries had negative rates of growth.																								
2. Per capita private consumption	The rank in terms of growth rate of per capita private consumption improved slightly between 1971–79 and 1980–87 (for 25 intensely adjusting (IA) countries the rank improved from 36 to 37). For 24 IA countries per capita private consumption increased in 1980 PPP\$ by 8.2% between 1970–79 and 1980–87.	The average rank in terms of growth in per capita private consumption declined slightly between 1971–79 and 1980–87. For 27 countries per capita private consumption increased in 1980 PPP\$ by 19.0% between 1970–79 and 1980–87.																								
3. Public expenditure in social sectors	Sectoral expenditure as % of total public expenditure in 11 IA countries: <table border="1"> <thead> <tr> <th>Year</th> <th>Educ.</th> <th>Health</th> <th>Total (social sectors)</th> </tr> </thead> <tbody> <tr> <td>1980</td> <td>14.8</td> <td>6.6</td> <td>36.2</td> </tr> <tr> <td>1986</td> <td>12.0</td> <td>5.5</td> <td>32.7</td> </tr> </tbody> </table> Per capita expenditure on education, health and social sectors in 1980 PPP\$ increased from 225.70 in 1980 to 227.30 in 1986.	Year	Educ.	Health	Total (social sectors)	1980	14.8	6.6	36.2	1986	12.0	5.5	32.7	Sectoral expenditure as % of total public expenditure in 12 countries: <table border="1"> <thead> <tr> <th>Year</th> <th>Educ.</th> <th>Health</th> <th>Total (social sectors)</th> </tr> </thead> <tbody> <tr> <td>1980</td> <td>10.0</td> <td>4.5</td> <td>25.7</td> </tr> <tr> <td>1986</td> <td>12.1</td> <td>4.7</td> <td>28.6</td> </tr> </tbody> </table> Per capita expenditure on education, health and social sectors in 1980 PPP\$ increased from 124.70 in 1980 to 188.90 in 1986 in 12 countries.	Year	Educ.	Health	Total (social sectors)	1980	10.0	4.5	25.7	1986	12.1	4.7	28.6
Year	Educ.	Health	Total (social sectors)																							
1980	14.8	6.6	36.2																							
1986	12.0	5.5	32.7																							
Year	Educ.	Health	Total (social sectors)																							
1980	10.0	4.5	25.7																							
1986	12.1	4.7	28.6																							
4. Infant mortality rate	In 23 IA countries, the rate of decline during 1977–82 was 12.7% and during 1982–87 was 12.6%.	In 29 countries, the rate of decline during 1977–82 was 13.0% and during 1982–87 was 11.2%.																								
5. Average undernutrition rate	For 24 IA countries: 7.81% in 1980 & 8.44% in 1986.	For 32 countries: -2.54% in 1980 and 4.31% in 1986.																								
6. Primary school enrollment rate	For 25 IA countries: 94.2% in 1980 & 90.1% in 1985.	For 33 countries: 86.0% in 1980 and 91.1% in 1985.																								

<sup>1</sup>The adjusting countries are (intensely adjusting countries are in italics): Burkina Faso, Burundi, *Cote d'Ivoire*, Central African Republic, Chad, Congo, Gabon, Gambia, Ghana, Guinea, Guinea-Bissau, Kenya, Madagascar, Malawi, Mali, Mauritania, Mauritius, Niger, Nigeria, Senegal, Sierra Leone, Somalia, Sudan, The United Republic of Tanzania, Togo, Uganda, Zaire, Zambia, Zimbabwe, Bangladesh, China, Indonesia, Republic of Korea, Nepal, Pakistan, Philippines, Thailand, Morocco, Tunisia, Turkey, Hungary, Yugoslavia, Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Guyana, Honduras, Jamaica, Mexico, Panama and Uruguay. For most indicators, information is limited to a subset of intensely adjusting countries.

<sup>2</sup>The nonadjusting countries are: Benin, Botswana, Cameroon, Ethiopia, Lesotho, Liberia, Mozambique, Rwanda, Myanmar, India, Malaysia, Papua New Guinea, Sri Lanka, Algeria, Egypt, Jordan, Oman, Syrian Arab Republic, Yemen AR, Yemen PDR, Poland, Portugal, Dominican Republic, El Salvador, Guatemala, Haiti, Nicaragua, Paraguay, Peru, Trinidad and Tobago, and Venezuela. For most indicators, information is limited to a subset of countries. For items 5 and 6 the number of countries exceeds the basic set of 31.

SOURCE: For items 2–6, Kakwani et al., 1990. Item 1 calculated from World Bank 1991C. As indicated in "Structural Adjustment and Income Distribution Issues and Experience," Azizur Rahman Khan, International Labor Office, Geneva, 1993, p. 36.

the state-planned economy, which will generate incentives for SOEs to be more competitive. On the other hand, if SOEs are suddenly faced with competition, they will probably fail, resulting in overwhelming fiscal and unemployment problems that will undermine political support for reform. It is precisely because of the possibility of such a disaster that developing country leaders waver so in their commitment to structural adjustment.<sup>110</sup>

Other analysts recommend a “big bang” approach to reform.<sup>111</sup> They point out that Eastern European countries such as Poland and the Czech Republic, which undertook reforms on all fronts and in one stroke, outperformed those that pursued a gradualist approach.<sup>112</sup> Big-bang advocates claim that partial reforms signal a lack of commitment, which is especially damaging in former communist countries where—given an institutional vacuum—perverse incentives tend to thrive. As in Russia, tentative reforms, they say, will likely give rise to both insufficient benefits and inadequate readjustment, resulting in political backlash.<sup>113</sup> Employing the big-bang rhetoric, the Russian government privatized state-owned enterprises in 1992, but balked when it came time to institute trade liberalization and stabilization measures.<sup>114</sup>

Diverse crosscultural experiences suggest there is no single recipe for success. In most cases, structural reform policies must be crafted to fit the situations at hand.<sup>115</sup> Rarely, if ever, do existing conditions adequately match the assumptions posited by economic theory.<sup>116</sup> And in some countries, there may be little room for choice, given prevailing social and economic conditions. Although gradualism may succeed in countries that have a strong and stable—albeit not necessarily democratic—institutional base, it may fail in cases, such as those in Eastern Europe, parts of Latin America, and Africa, where there is a lack not only of market institutions but also of strong civic traditions.<sup>117</sup> In such environments, successful programs will require a broader, multifaceted approach that addresses institutional as well as economic needs.

### ■ Need for a More Integrated and Multifaceted Approach to Development

Difficulty in explaining the variable outcomes associated with economic reforms across countries and cultures signals the need for a broader approach to economic development, which takes political and cultural factors into account.<sup>118</sup> Economic analysis is necessary to understand

<sup>110</sup> Ibid.

<sup>111</sup> Jeffrey Sachs and Wing Thye Woo, “Understanding the Reform Experiences of China, Eastern Europe and Russia,” in OECD, *From Reform to Growth*, op. cit., footnote 104, pp. 23–48; See also Ronald I. McKinnon, *Rapid Liberalization in Socialist Economies: Financial Policies in China and Russia Compared* (San Francisco, CA: International Center for Economic Growth, 1994); D. Papageorgiou, M. Michaely, and A. M. Choski (eds.), *Liberalizing Foreign Trade* (Oxford, UK: Blackwell, 1991); and Paul Collier and Jan Willem Gunning, “Aid and Exchange Rate Adjustment in African Trade Liberalization,” *Economic Journal*, vol. 102, No. 413, July 1992.

<sup>112</sup> The Czech and the Slovak Republics, for example, both experienced major unemployment crises in the post-reform period. Beginning in 1991, unemployment in the Slovak Republic rose to 12.7 percent in 1992. See John Ham, Jan Svejnar, and Katherine Terrel, “The Emergence of Unemployment in the Czech and Slovak Republics,” *Comparative Economic Studies*, vol. 35, No. 4, winter, 1993, pp. 121–133; See also Saul Estrin, “Industrial Restructuring and Microeconomic Adjustment in Poland: A Cross-Sectoral Approach,” *Comparative Economic Studies*, vol. 35, No. 4, winter 1993, pp. 1–19.

<sup>113</sup> Grant Kirkpatrick, “Transition Experiences Compared: Lessons from Central and Eastern Europe’s Reform,” in OECD, *From Reform to Growth*, op. cit., footnote 104, pp. 95–119; and Sachs and Woo, op. cit., footnote 111.

<sup>114</sup> Sachs and Woo, footnote 111, p. 27.

<sup>115</sup> Comparative analysis now shows that the *stage* of development at which policies are introduced is perhaps the most important variable determining success. See, for a comprehensive discussion, Zehra F. Arat, *Democracy and Human Rights in Developing Countries* (Boulder, CO: Lynne Rienns Publishers, 1991).

<sup>116</sup> As Kahn points out, “Growth prospects may actually be harmed by any number of inflexibilities so characteristic of the developing countries,” Kahn, op. cit., footnote 100, pp. 12–13.

<sup>117</sup> For a comparison of the Eastern European and Latin American contexts, see Tina Rosenberg, “Overcoming the Legacies of Dictatorship,” *Foreign Affairs*, vol. 74, No. 3, pp. 134–152.

<sup>118</sup> Arat, op. cit., footnote 115.

development failures and to design better ways to improve Third World economic prospects. But economic analysis, by itself, is not enough. Failed efforts result not only from the particular sequence in which reforms are introduced but also from the fragile political and institutional environment in which they are implemented and consolidated.<sup>119</sup> If future foreign assistance programs are to promote sustainable economic development, which supports democracy and political stability, social and political factors must be better incorporated into their design.

Because structural adjustment measures emphasize the shift of economic activity from the public to the private sector, the government's critical role in reform efforts has often been downplayed.<sup>120</sup> However, market reform does not—as might be implied—entail the “withering away of the state.” To the contrary, the state—at least in the initial phases of reform—must play a central role both in creating and in preserving economic markets. At the most fundamental level, for example, it is government that determines the norms governing market behavior. Governments also define economic actors—proprietors, workers, and corporations—by establishing and enforcing their rights and obligations, the rules by which they interact, and the means

they use for exchange. These decisions are of major importance, determining both economic opportunities and the performance of the economy as a whole.<sup>121</sup>

The challenges facing governments shifting from a command to a market economy are monumental. Political leaders must not only design and implement a new legal and institutional framework to govern emerging markets; they must also—and at the same time—generate a political consensus to support these arrangements as well as consolidate their own political power. The time frame for achieving success is, moreover, highly compressed.<sup>122</sup>

The overwhelming problems encountered in executing economic reforms raise fundamental questions about today's operating model of economic development, central to which is the assumption that economic freedoms and political freedoms go hand in hand.<sup>123</sup> Experience with economic reforms suggests, however, that this is not necessarily the case. Democratic governments, for example, appear to be somewhat disadvantaged in carrying out market reforms.<sup>124</sup> Depending for their existence on popular support, democratic leaders are more vulnerable than their authoritarian counterparts to ideologi-

<sup>119</sup> Jose Maria Maravall, “The Myth of Authoritarian Advantage,” *Journal of Democracy, Economic Reform and Democracy*, Special Issue, October 1994, pp. 22–23. See also Stephan Haggard and Robert R. Kaufman, “The Challenges of Consolidation,” in *Journal of Democracy*, *Ibid.*, pp. 5–6.

<sup>120</sup> See Jan Kregel, Egon Matzner, and Gernot Grabher, *The Market Shock* (Vienna, Austria: Austrian Academy of Sciences, Research Unit for Socioeconomics, 1992).

<sup>121</sup> See Douglas C. North, *Institutions, Institutional Change, and Economic Performance* (Cambridge, UK: Cambridge University Press 1990); see also Joseph Stiglitz, “Social Absorption Capability and Innovation,” CEPR Publication No. 292, *Center for Economic Policy Research*, Stanford CA, November 1991.

<sup>122</sup> See, for discussion of the importance of sequence, E.A. Nordlinger, “Political Development, Time, Sequence and Rates of Change,” in Jason L. Finkle and Robert W. Gable (eds.), *Political Development and Social Theory* (New York, NY: John Wiley and Sons, 1976), pp. 455–471; Leonard Binder, James S. Coleman, Joseph LaPolembara, Lucien Pye, Sydney Verba and Myron Weiner (eds.), *Crisis and Sequence in Political Development* (Princeton, NJ: Princeton University Press, 1971); and Dankwart A. Rustow, “Transitioning to Democracy: A Global Revolution?” *Foreign Affairs*, vol. 69, No. 4, fall 1990, pp. 75–91.

<sup>123</sup> This assumption received support from the crossnational quantitative research program led by sociologist Seymour Martin Lipset in the late 1950s and early 1960s. Using a wide range of indicators, these researchers found a positive correlation between the level of economic development and democracy. Subsequent analyses have shown the relationship between democracy and economic development to be much more complex. As described by Arat, “Increasing levels of economic development do not necessarily lead to higher levels of democracy, even for the less developed countries....Developing countries do not display a linear relationship but instead more complex patterns or no relationships at all. In fact, in most of these countries, especially the ones located in the middle of the development axis, there is a higher level of instability—a continuous back and forth shift. See Arat, *op. cit.*, footnote 115, p. 49. See also Evelyn Huber, Dietrich Rueschemeyer, and John D. Stephens, “The Impact of Economic Development on Democracy,” *Journal of Economic Perspectives*, vol. 7, No. 3, summer 1993, pp. 71–85.

<sup>124</sup> Adam Przeworski and Fernando L. Inougi, “Political Regimes and Economic Growth,” in *Journal of Economic Perspectives*, vol. 7, No. 3, summer 1993, pp. 51–69.

cal contradictions, institutional failures, and lobbying by special interests. When democratic governments fail in their reform efforts, public support for democratic values, as well for the prevailing government, is jeopardized.

Political pressures to dilute and delay reform are likely to be particularly greater early on when costs are already apparent but benefits are still elusive. It is precisely at this point, however, that political leaders must rise above the immediate crisis to undertake the kinds of long-term legal and institutional changes that serve universal rather than particularistic goals. Since democratic politicians are periodically held accountable to the electorate, the time they have to forge such a consensus is very short.<sup>125</sup>

Privatization, deregulation, and liberalization programs may also be problematic for democratic regimes if they are carried to extremes, making it impossible for governments to generate sufficient resources to carry out their programs. Such was, in fact, the case in Latin America, where trade liberalization during the 1980s led to a rapid decline in state revenues.<sup>126</sup> Faced with major fiscal problems, Latin American governments were forced to cut back on public expenditures, causing the deterioration of infrastructure and a decline of many services. Public discontent mounted as a result, giving rise to widespread political instability.

If overly stringent, economic reforms may also inhibit adequate investments in social policies, which are necessary to provide some buffer to groups bearing an inordinate burden due to

reforms. Trading off social goals—such as equity—has proven at best unnecessary and at worst self-defeating.<sup>127</sup> As experience in Asia and Southern Europe makes clear, when governments have carried out social programs in conjunction with economic reforms, the results have been very successful indeed. In contrast, if governments fail to take social justice into account, interest groups often pit themselves against one another, thereby undoing the very basis for political consensus.<sup>128</sup>

Acknowledging the political constraints that many developing countries face in executing economic reforms, foreign assistance organizations have designed new programs to help political leaders improve their governing capacity. The World Bank, for instance, had added the notion of “good governance” to its development repertoire.<sup>129</sup> Good governance, the World Bank argues, is a prerequisite for successful reform. Recognizing that many political leaders lack the experience and skill required to carry out such reforms, the Bank has initiated assistance programs to help them build up their governments’ administrative and legal capacities.<sup>130</sup>

While these types of government-oriented assistance programs address some of the formal legal and administrative problems associated with carrying out structural economic reforms, they are inadequate for dealing with the rampant problems of political disorder and social upheaval to be found in many developing coun-

<sup>125</sup> Stephan Haggard and Robert R. Kaufman, op. cit., footnote 119, pp. 5–6.; Joan M. Nelson, “Linkages Between Politics and Economics,” in *Journal of Democracy*, op. cit., footnote 119, p. 54; and Jose Maria Maravall, “The Myth of Authoritarian Advantage,” in *Journal of Democracy*, op. cit., footnote 119, p. 17–31.

<sup>126</sup> Moses Naim, “Latin America: Second Stage of Reform,” in *Journal of Democracy*, op. cit., footnote 119, pp. 32–48.

<sup>127</sup> As Haggard and Kaufman note, “When citizens believe that the costs of reform are distributed fairly, economic reforms are more likely to succeed and democratic regimes are more likely to survive.” Stephen Haggard and Robert Kaufman, op. cit., footnote 119, p. 12.

<sup>128</sup> *Ibid.*, and Naim, op. cit., footnote 126, pp. 32–48.

<sup>129</sup> The World Bank, *Governance and Development* (Washington DC: The World Bank, 1992). It should be noted that the World Bank’s mandate as laid out in its Articles of Agreement limits its ability to become involved in political issues per se. Thus, for example, it cannot interfere in the partisan politics of a member. Nor can it use its lending policies to influence the political situation in a recipient country.

<sup>130</sup> Good governance, according to the World Bank, can be measured by the degree to which developing countries are able to establish clear boundaries between the public and private spheres, minimize government rules and regulations, and institute economic incentives and a framework of law and governance that is transparent, predictable, and conducive to economic growth.

tries today.<sup>131</sup> Nor will such programs necessarily serve democratic goals.<sup>132</sup> As history makes all too clear, efficient government administration is no guarantee against autocratic or totalitarian governments; to the contrary, it is typically required to sustain them.

For both democracy and free markets to thrive, what is required is not simply the reemergence of strong, competent states but rather the redefinition and balancing of their roles and relationship with respect to both the marketplace and society at large. As a growing body of evidence makes clear, social and cultural institutions that foster trust and cooperation constitute a form of “social capital” that supports both free markets and democracy, and at the same time serves to better balance the relationship between them (see box 2-4).<sup>133</sup>

Most developing countries have very little of this social capital on which to build either efficient markets or sustainable democracies. To the contrary, the political culture in many of these countries fosters distrust and alienation. Based on authority and dependency, interpersonal relations are characterized not by mutual respect and reciprocity, but rather by distrust and alienation.<sup>134</sup>

If developing countries are to extricate themselves from the vicious circle that leads to political, economic and environmental decay, they must begin by making much greater investments

in the development of social capital. Building trust, however, represents a problem of collective action—the classic case of the “prisoner’s dilemma.” Living in a society that is devoid of trust and goodwill, people are unlikely to act in mutually beneficial ways, even when it serves their own best interest. Each person fears that, if he or she is the first to act honestly, others will surely take advantage.

Broadbased foreign assistance programs can foster the development of trust, thereby providing greater basis for cooperation. Once started, cooperation tends to be self-sustaining, so investment in cooperative behavior can have a high payoff.<sup>135</sup> Over time, it can generate a wealth of social capital, which can be drawn on in future times of trial.

Comprehensive, multifaceted aid programs are also necessary to balance multiple foreign assistance goals, directing policymakers to focus on the development of mutually reinforcing policy criteria. Efforts to promote “sustainability” provide an example of one such approach.<sup>136</sup> Given a growing awareness of the potential negative impacts that economic growth might have on the global environment, academics, policymakers, nongovernmental organizations, and businesses alike have worked since the Rio Declaration of 1992 to define and operationalize the goal of “sustainability,” so that it might be better

<sup>131</sup> See, for one critical view of the Banks Governance Program, Mick Moore, “Declining To Learn From the East? The World Bank on ‘Governance and Development.’” *IDA Bulletin*, vol. 24, No. 1, 1993, pp. 39–50. See also Carol Lancaster, “Governance and Development: The Views From Washington,” *IDA Bulletin*, vol. 24, No. 1, 1993.

<sup>132</sup> As described by Naim with reference to Latin America, “Paradoxically, the high interventionist doctrines that gave the state a virtual monopoly over a vast array of activities greatly contributed to its decline. Even while the state was stretched far beyond its capacities, its economic centrality and political voraciousness hindered the emergence and development of spontaneous forms of social organization (clubs, nongovernmental organizations, voluntary organizations, civic forums, and so on) that constitute the backbone of what Robert Putnam calls “social capital.” Without patterns of social cooperation based on tolerance, trust, and widespread norms of active citizen participation, the modicum of political stability required for the effective operation of public bureaucracies is periodically lost.” Naim, *op. cit.*, footnote 126, p. 42.

<sup>133</sup> See, in particular, Robert Putnam, *Making Democracy Work* (Princeton, NJ: Princeton University Press, 1993); and also Fred Block, *Postindustrial Possibilities: A Critique of Economic Discourse* (Berkeley, CA: University of California Press, 1990), pp. 41–42.

<sup>134</sup> Putnam, *op. cit.*, footnote 133, p. 88.

<sup>135</sup> Robert Axelrod, *The Evolution of Cooperation* (New York, NY: Basic Books, 1984).

<sup>136</sup> The pursuit of “sustainability,” has been inspired by findings from the World Commission on Environment and Development (the Brundtland Commission), the 1992 U.N. Conference on Environment and Development, and a host of reports emanating from such bodies as the World Bank, the Organisation for Economic Cooperation and Development (OECD), and the Business Council for Sustainable Development, which warn that a continuation of current patterns of economic growth could result in levels of environmental degradation severe enough to jeopardize the ability of future generations to meet basic needs. Global environmental problems, including loss of biodiversity, climate change, and stratospheric ozone depletion, have become increasingly of concern.

#### BOX 2-4: The Role of Social Capital in Supporting Free Markets and Democratic Politics

Cooperative social relations and interactions can make markets more efficient and political interactions more effective. For example, all market activities are based on some form of cooperative human interaction, which is sustained by social networks. Well established social networks help to reduce the costs of market transactions because the participants need to acquire less information to do business.<sup>1</sup> If buyers and sellers are well known to each other, their shared expectations and mutual trust allow them to come to terms without having to haggle over prices. Similarly, given the existence of social sanctions, they do not need to expend energy making sure that bargains are kept. By reducing these kinds of “transaction costs,” social networks help markets operate more effectively. To the extent that this is the case, there is less need for government to intervene with rules and regulations. Cooperative behavior similarly reinforces democratic values and participation. Over time positive social interactions give rise to societies based on trust and civic norms.<sup>2</sup> In a civic culture, people interact with each other as equals and according to cooperative and reciprocal norms.<sup>3</sup> When people support one another voluntarily, there is similarly less need for government in private life.

<sup>1</sup> See Douglas C. North, *Institutions, Institutional Change, and Economic Performance* (Cambridge, UK: Cambridge University Press 1990).

<sup>2</sup>See, for instance, Gabriel A. Almond and Sidney Verba, *The Civic Culture: Political Attitudes and Democracy in Five Nations* (Princeton, NJ: Princeton University Press, 1963). See also Robert N. Bellah, Richard Madsen, William M. Sullivan, Ann Swidler, and Stephen M. Tipton, *Habits of the Heart: Individualism and Commitment in American Life* (New York, NY: Harper and Row, 1986)

<sup>3</sup>Robert Putnam, *Making Democracy Work* (Princeton, NJ: Princeton University Press, 1993).

SOURCE: Office of Technology Assessment, 1995.

incorporated into development policies.<sup>137</sup> To explore such questions, the Clinton Administration has recently constituted the Council on Sustainable Development, which is composed of 25 U.S. government, business, and environmental leaders. This council, meeting for two years, aims to develop a set of plans and policies to ensure continued economic growth without damage to human health and natural resources.<sup>138</sup> Other governments and organizations are pursuing similar efforts.<sup>139</sup>

More recently, new policy goals such as poverty alleviation and the promotion of women's rights, are also being brought to the fore. Although international meetings such as the

World Summit on Social Development are necessary to highlight the need to pursue such goals, care must be taken to assure that—like sustainability—these goals are not pursued single-mindedly but are rather incorporated into a broad-based development program.

Comprehensive foreign assistance programs can serve not only to promote holistic development; they can also foster improved trading relationships with Third World countries at a time when these markets are rapidly growing in size. Development programs that are based on reciprocal, cooperative interactions among donors and recipients can generate ongoing social and economic networks that spill over into trading relation-

<sup>137</sup> Maurice F. Strong, “From Rio to Copenhagen,” *Futures*, vol. 27, No. 2, March 1995, pp. 238–240.

<sup>138</sup> Glen Hess, “President’s Council Seeks Growth While Protecting Environment,” *Chemical Marketing Reporter*, vol. 245, No. 17, April 25, 1994, p. 27.

<sup>139</sup>Included among these, for example, are Holland’s National Environmental Policy Plan, *To Choose or To Lose*; the UK’s White Paper, *This Common Inheritance and Sustainable Development: The UK Strategy, 1994*; Japan’s *New Earth 21*; and the European Commission’s Fifth Environmental Action Programme—*Toward Sustainability*. Also underway is the 2050 Project, a 4-year effort by the World Resources Institute, the Brookings Institute, and the Santa Fe Institute to define the conditions under which the global society might be sustainable in the year 2050.

**BOX 2-5: Japanese Support for Standard Setting**

The Japanese have sent technical experts to five developing countries to assist them in the development of their standards program. In the Philippines, for example, the Japanese International Cooperation Agency conducted a 13-person team, 500-person-day study of the Philippine national standardization system and provided a U.S.\$23.1 million grant to establish three regional labs. At the same time, the Japanese Government has paid for 28 people from developing countries to come to Japan for language and technical standards training.

SOURCE: Office of Technology Assessment, 1995.

ships. Participating donor countries can gain a considerable competitive trade advantage as a result without violating the principles of free trade.

The Japanese have been particularly successful in establishing these kinds of aid networks (see box 2-5). Now the world's largest donor country—with contributions totaling \$11.26 billion in 1993—Japan has recently moved to broaden its assistance programs to focus more on environmental, population, and healthcare goals.<sup>140</sup> At the same time, the proportion of Japanese aid that is tied to the purchase of Japanese products is on the decline. In 1993, for example, 82.9 percent of Japan's total overseas development assistance was untied, as was 96.9 percent of its foreign assistance loans.<sup>141</sup> Instead of using tied aid to promote its commercial ends, the Japanese are leveraging their own economic development model, in the hope that trade will follow the path of shared research, training, technology transfer and personal exchanges. Not surprisingly, therefore, much of Japan's aid is centered in Asia, which is fast becoming Japan's largest market.<sup>142</sup>

## A FOREIGN ASSISTANCE MODEL FOR THE FUTURE

Notwithstanding the growing disillusionment and disappointment in the outcomes of many for-

foreign assistance programs, foreign aid will probably continue to serve as major policy instrument in the United States foreign policy repertoire. Just as the Cold War led a reluctant Congress to provide concessionary aid in the 1950s, and the foreign debt crisis in the 1980s led the Reagan Administration to help resolve the international debt crisis, so future governments will likely utilize foreign aid policy in an effort to limit the damage due to environmental impacts, natural disasters, civil wars, and international conflicts. Given such a likelihood, it behooves foreign policymakers to reflect on past successes and failures.

Looking at any one particular segment of time, U.S. foreign assistance appears to conform to a model in which goals, policy tools, policy mechanisms, and policy outcomes are laid out in a linear fashion. Standing back and surveying the last 50 years all at one glance, however, the picture is not quite so orderly. Although overall goals have remained relatively stable over time—albeit with some shifts in emphasis—the means adopted to achieve them have been altered quite abruptly, as new situations arose, different political ideologies gained prominence, and new models of economic development came into vogue. Seen from this long-term perspective, foreign assistance corresponds much more to the sharp swings of a pendulum. Thus, for example,

<sup>140</sup> Hiroshi Hirabayashi, "Changes in the International Environment and the Direction of Japan's ODA," *Japan 21st*, vol. 39, No. 12, December 1994, pp. 23–27; and Peter Evans, "Japan's Green Aid," *The Chinese Business Review*, July/Aug. 1994, pp. 39–43.

<sup>141</sup> *Ibid.*

<sup>142</sup> Jonathan Friedland, "The Regional Challenge: Asia Has Become Japan's Biggest Market," *Far Eastern Economic Review*, June 9, 1994, pp. 40–42.

whereas at one point the transfer of capital was viewed as the key to success, the emphasis soon thereafter shifted 180 degrees to a poverty-oriented, basic needs approach, later moved again in a radically different direction with attention focused on structural economic reforms, economic sustainability, and more recently back again to poverty alleviation and basic needs.

Having focused on a single “right” way of achieving economic development, which presumably could be applied to all settings and circumstances, policymakers reacted to each failure by darting off in new directions in search of new solutions. Little effort was made in the process to draw on the more positive aspects of each approach so as to weave them into a comprehensive package.

Today, the United States’ stake in the fate of Eastern Europe and the developing world is commensurate with its interest, 50 years ago, in the revival of postwar Europe. Just as in 1945—when the U.S. government recognized that its own economic recovery was dependent on that of Europe—so today policymakers find that the United States’ greatest trading opportunities are now situated in Eastern Europe and the Third World. If the United States is to benefit from these opportunities, it will need to promote the health of Third World economies as well as their successful integration into the global economy. As the debt crisis and—more recently—the devaluation of the Mexican peso makes clear, in an increasingly global economy, economic problems, even when they emerge in developing countries, quickly reverberate throughout the industrial world.

U.S. security interests are also inextricably tied to Third World developments. Just as the United States adopted the Marshall Plan in an effort to shore up the power vacuum created by the collapse of the interwar international system, so the U.S. government is increasingly being called on to maintain peace across the globe. Given the demise of the Soviet Union and—with

it—the collapse of the Cold War defense system, states and political regimes are, one by one, coming apart at the seams. To “contain” the violence, the United States has found it necessary to become engaged in 21 new peacekeeping operations in the period between 1988 and 1994 (as opposed to 13 during the period from 1947-1988).<sup>143</sup>

Developing appropriate foreign aid policies to address these global challenges can benefit greatly from the lessons of the past. The case of the Marshall Plan is particularly instructive, given its fundamental success. What distinguishes the Marshall Plan experience from subsequent aid programs is the extent to which aid policy tools were tailored—whether purposefully or not—to the situation at hand (see table 2-3). Equally important was the degree to which policy tools served to reinforce multiple foreign aid goals.

Thus, for example, the U.S. decision to make aid contingent on European structural economic reforms was coupled with changes in the U.S. economy as well as to the broader revision of the international monetary system. Similarly, the transfer of financial capital to Europe was linked to the prospect of future U.S. trade opportunities there. Likewise, postwar defense arrangements in Europe not only served to protect the West against the Soviet threat; they also promoted regional political stability so that Western European governments could focus their attention on cooperation and economic growth.

Today’s situation is considerably less conducive to success, as can be seen in table 2-3. Trade policies are now intensely competitive; fewer resources are available for aid; the United States and other donor countries are increasingly preoccupied with domestic issues; the goals of the United States and recipient countries (as well as other donor countries) are often in conflict; recipient countries lack the political and social resources to fully benefit from aid, etc.

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<sup>143</sup> Mark M. Lowenthal, *Peacekeeping and U.S. Foreign Policy: Implementing PDD-25*, CRS Issue Brief, IB94043, Updated Sept. 23, 1994.

Designing successful aid programs in this context will be very challenging indeed. To be successful, aid policies must not only promote economic growth; they must also foster the development of social, political, and economic institutions that are conducive to the generation and equitable distribution of wealth. These policies will, moreover, need to be implemented using fewer resources spread over a broader array of situations and locales. Thus, aid policies will need to be highly cost-effective and mutually reinforcing, pooling and leveraging resources whenever possible.

Despite previous disappointments and the prospect of even greater challenges in the future, foreign aid will likely continue to serve as an

important policy tool for fostering U.S. foreign policy goals. In an increasingly interdependent, global economy, the alternatives to foreign aid—whether they be national isolationism or the use of military force—will often be counterproductive.

Drawing on the lessons of the past in the light of the present conditions, table 2-3 identifies a number of policy strategies that, when joined together into an integrated package, might serve as the basis for developing a revised foreign aid model that is more suitable for today. At a minimum, in fashioning telecommunication-related aid policies to promote the United States' foreign policy goals, these strategies can serve as a useful starting point.

TABLE 2-3: Criteria for Successful Development Aid

Key Factors	Status of World Economic Regulation	Quantity and Allocation of Resources Devoted to Aid Programs	National Support/ Perceived Stakes Involved
<b>Marshall Plan</b>	Expanding trade in the context of trade liberalization and internationally coordinated post-War monetary system	High levels of mutually reinforcing financial and military commitments were focused on Europe. The U.S. spent \$554 billion (an average of \$138 billion in 1981 prices). Joint participation in defense arrangement with the formation of NATO.	Stakes were perceived as very high and linked to the notion of containing the Soviet threat. President Truman's Four Point Program provided a vision to sustain political support for aid.
<b>Today's Context</b>	Increased integration and interdependence in global economy, driven by growth in trade, transnational corporations and financial institutions. Aggressive trade policies to capture big emerging markets. Trade liberalization accompanied by new forms of protectionism. Strain on post-War international monetary system.	Dollar amount of economic aid in the aggregate is equivalent to the Marshall-Plan era, but resources are spread more thinly and unevenly. Areas requiring economic aid are not necessarily the same as those requiring military assistance. A large proportion of U.S. assistance focused on strategically important areas such as Egypt and Israel.	Shift in concern from international issues to domestic problems — growing Federal debt. General questioning of the cost-effectiveness and success of aid programs.
<b>Today's Policy Challenge</b>	Incorporate developing countries into the global economy with win-win outcomes for all.	Develop more cost-effective ways to promote aid goals.	Greater vision for aid policy that better relates to present U.S. priorities and concerns (i.e., trade).
<b>Today's Policy Criteria</b>	<ol style="list-style-type: none"> <li>1) Develop mutually beneficial trade agreements.</li> <li>2) Aid to support global economic institutions in developing countries — i.e. standards, financial markets, infrastructure privatization, regulatory reform.</li> </ol>	<ol style="list-style-type: none"> <li>1) Leverage across programs and agencies</li> <li>2) Gain economies of agglomeration by focusing comprehensive programs more locally.</li> </ol>	<ol style="list-style-type: none"> <li>1) Global exchange programs</li> <li>2) Involvement of business and other key groups in executing aid programs.</li> </ol>

**TABLE 2-3: Criteria for Successful Development Aid (Cont'd.)**

Donor/Recipient Relationship	Social/Political/Institutional Context of Recipient Countries	Measurability of Success/ And Feedback	Key Factors
<p>Aid to Europe provided on a quid-pro-quo basis involving economic reforms and European regional cooperation. But U S and Europe were in basic Ideological agreement about post-War priorities and institutions Europeans negotiated and helped design the structure of the Marshall Plan</p>	<p>A shared common history and continuity of political and economic institutions and a socioeconomic infrastructure was capable of absorbing and efficiently allocating aid resources</p>	<p>Aid programs fostered both economic and security goals and were perceived as being highly effective Because of its widely acclaimed success, the Marshall Plan served as the respiration for U S bilateral aid to developing countries,</p>	<p><b>Marshall Plan</b></p>
<p>We-They attitude persists as a result of debt crisis when donors imposed conditions on aid recipients. Developing countries are now more inclined toward liberalization and greater integration into the world economy, but many find Asian development model more appealing than U.S. version.</p>	<p>Diverse settings, weak institutional frameworks, problems of political disorder and social upheaval</p>	<p>Few consensus measures of success General perception of poor performance and failure of aid to have an impact. Inadequate feedback mechanisms to achieve aid accountability and improve development models</p>	<p><b>Today's Context</b></p>
<p>Find ways to negotiate aid agreements that enhance donor-recipient cooperation and that are mutually responsive to both sets of needs</p>	<p>Develop comprehensive aid programs that foster social/political institution-building without undermining economic reforms</p>	<p>Enhance our understanding of the development process and develop qualitative and quantitative measures to better evaluate aid programs</p>	<p><b>Today's Policy Challenge</b></p>
<p>Revitalize existing forums or establish new forums that cut across G7/G66 boundaries where aid conditions can be negotiated in the context of joint interests</p>	<p>Incorporate into aid policies mechanisms to foster cooperation that build on existing cultural strengths and social networks</p>	<p>1 ) Experiment with small, Innovative pilot projects 2) Develop databases and networks for collecting and disseminating aid-related information and results</p>	<p><b>Today's Policy Criteria</b></p>

SOURCE: Office of Technology Assessment, 1995.