

**Anne O. Krueger, Constantine Michalopoulos and Vernon W. Ruttan.** *Aid and Development*. Baltimore: The Johns Hopkins University Press. 1989. xiv + 386 pp. Price: U.S. \$ 52.00

Foreign aid has been the subject of much examination and research ever since it entered the economic armamentarium approximately 45 years ago. This was the time when the Second World War had successfully ended for the Allies in the defeat of Germany and Japan. However, a new enemy, the Soviet Union, had materialized at the end of the conflict. To counter the threat from the East, the United States undertook the implementation of the Marshal Plan, which was extremely successful in rebuilding and revitalizing a shattered Western Europe. Aid had made its impact.

The book under review is by three well-known economists and is the outcome of a study sponsored by the Department of State and the United States Agency for International Development. The major objective of this study was to evaluate the impact of assistance, i.e., aid, on economic development. This evaluation however, was to be based on the existing literature on the subject.

The book has five major parts: Part One deals with development thought and development assistance; Part Two looks at the relationship between donors and recipients; Part Three evaluates the use of aid by sector; Part Four presents country case-studies; and Part Five synthesizes the lessons from development assistance.

Part One of the book is very informative in that it summarises very concisely the theoretical underpinnings of the aid process. In the beginning, aid was thought to be the answer to underdevelopment which could be achieved by a transfer of capital from the rich to the poor. This approach, however, did not succeed as it was simplistic. Capital transfers were not sufficient in themselves to bring about development, as research in this area came to reveal. The development process is a complicated one, with inputs from all sectors of the economy. Thus, it came to be recognized that factors such as low literacy rates, poor health facilities, and lack of social infrastructure are also responsible for economic backwardness. Part One of the book, therefore, sums up appropriately the various trends in development thought. This is important because the book deals primarily with the issue of the effectiveness of aid as a catalyst to further economic development.

Part Two of the book deals with the relationship between recipients and donors in the context of aid effectiveness. It is stressed that if recipients adopt the appropriate economic policies or, more specifically, if relative prices of inputs and outputs reflect their true opportunity cost by sending the right signals to producers, then foreign assistance is quite effective in the strict economic sense of raising output and growth rates. For donors, the compulsions of offering assistance may not be purely economic; political and military reasons also influence the granting of assistance. In this case, the economic effectiveness of aid is reduced. This

particular situation arises in cases of bilateral assistance. Multilateral lending agencies, however, are not influenced by such considerations and their aid efforts are based more on economic criteria. It has also been stated in the book that, for successful utilization of aid, there should be close coordination between the recipients and the donors. One example which has been cited in this connection is the programme initiated by the World Bank to provide assistance to the countries of the Sub-Saharan region of Africa. Although it may be difficult to quantify the economic effects of the improved coordination efforts between donors and recipients, qualitatively, nevertheless, it is apparent that aid effectiveness improves in the presence of aid coordination among donor countries and agencies.

Part Three of the book presents evidence, in purely economic terms, about the impact of aid in different sectors of the economy for various countries. Thus, Chapters 8–11 deal with the effect of aid on the development of infrastructure, on agricultural production, on the improvement of living standards in the rural areas, and on population assistance.

The economic effectiveness of aid for developing the basic infrastructure has been quite positive, as it has resulted in tangible increases in output in countries such as India and Korea. However, pricing, as in the case of water charges, is a problem area. This is particularly so in the case of Pakistan where, given its feudal power structure, water charges are much below the rate required from the economic point of view.

Part Four of the book consists of country case-studies. These case-studies examine the issue of the effectiveness of aid in the following countries: India, Korea, Turkey, Ghana, and the Ivory Coast. The framework of the case-studies is based on three areas of interest: (a) domestic economic policy and the effectiveness of aid; (b) policy dialogue between donor and recipient, and its impact on the effectiveness of aid; and (c) the impact of aid on economic growth.

In the case of India, foreign aid inflows have been relatively small as compared to her GNP as well as on the per capita basis. Food aid, however, did have a significant impact as it helped relieve shortages in the Sixties and early Seventies. Now, with India producing enough food to feed its population, aid inflows are less than 2 percent of the Indian national income.

However, although the overall levels of aid may not have been much, this does not mean that aid did not play an important role in developing various sectors of the Indian economy. In fact, foreign-aided projects in agriculture and rural development yielded very profitable returns. Specifically, the green revolution technology with its emphasis on the high-yielding varieties of crops and improved methods of cultivation would not have been possible without substantial allocations for education and research. Although the aid effectiveness has been high, yet problems exist; and these relate to the relationship between donor and recipient, in

particular the World Bank group and India.

The second case-study is on South Korea, whose progress has been phenomenal. Aid was effectively utilized, which was largely due to the convergence of views between donor and recipient, in this case the USA and South Korea. However, when the Koreans felt that the policies being suggested by the donors were incorrect, they rejected them. In the end, it was the adoption of appropriate economic policies which reduced investment and savings gaps as well as removing import constraints that resulted in the incredible progress of the South Korean economy. As far as agriculture is concerned, the sector benefited from Korean economic growth rather than acting as the major contributor to that growth.

The case-study on Turkey also looks at infrastructure development, agricultural production, rural development, and the effect of aid on family planning. A general conclusion that emerges is that building an institutional infrastructure is more important than the physical infrastructure. Also, if the correct economic incentives are given, farmers and other economic agents will respond to them. The fact that these were not provided helped obstruct Turkish economic development. Another factor which made it difficult to follow the appropriate economic policies was the interaction at the political level between the USA and Turkey, when the political considerations were often considered to be of greater importance than the economic ones. Thus, powerful economic decisions were either postponed or not taken, which meant that Turkish economy would not develop – to its fullest potential.

The last case-study concerns Ghana and the Ivory Coast. Here aid effectiveness has been affected by the lack of consensus on the appropriate policy reform as suggested by the donors but rejected by the recipients. Also, in this case donor policies were not thought out properly. However, the importance of following the appropriate macroeconomic policies along with trade and exchange rate policies can be discerned from these two case-studies.

Part Five of the book sums up the lessons of development assistance. According to the evidence presented, the condition under which development aid is successful, is to follow a policy of export-led growth with the appropriate deregulation of government controls on various sectors of the economy. Export-led growth has three advantages: first, it allows countries to seek their comparative advantage; secondly, the costs of following a highly protectionist policies are avoided; and thirdly, it makes governments adopt policies that encourage improved economic performance by the private sector.

So far as policy dialogue and aid effectiveness are concerned, it is self-evident that when the donor and recipient views converge and they share common political and economic interests, the impact of aid is high.

The effect of aid on raising the growth rate of a country is not easily dis-

cernible for a number of reasons. As mentioned in the book, economic considerations are not the only reasons for which aid is given; political considerations have often been more important. As there are plenty of examples of this, it becomes difficult to assess the impact of aid on economic growth. Also, official development assistance, as aid has been defined in this book, has not formed a very large share of the total funds that have been available for development purposes.

The book has two positive features. The first is that it presents, in the initial chapters, a very good and concise discussion about aid and how it is related to the history of development. This discussion is all-encompassing and, to a student of the topic, very informative. The second positive feature is the very extensive bibliography on aid which is presented at the end of the book. This bibliography is comprehensive, covering all shades of the political spectrum. Thus, Teresa Hayter is listed on the *left* side of the political map to match the many neoclassical economists who occupy the *right* side of the political spectrum. The case-studies are useful in that they prove that an *ex post facto* evaluation reveals whatever has gone wrong or right, as the case may be, so that the lessons for the future may be learnt.

To conclude, however, one must keep several points in mind. This book looks at aid and development from a narrow economic perspective, stating conditions wherein aid effectiveness can be high. These conditions depend to some extent on the political relations between donors and recipients, but on the economic side the familiar bias in favour of the free market is very much there. Prices, which are determined by the market forces of demand and supply, reflect true opportunity costs and help bring about better resource allocation. This is one message that is delivered in this book. The other message is the one in favour of export-led growth. This type of growth is dynamic and can lead the country following it to generate balance-of-payments surpluses. However, this path to development is not without some risk, especially now that the protectionist tendencies are running high in the developed countries, and coupled with the fact that world trade is growing slowly.

Finally, if the purpose of aid is to bring about a real transfer of resources to the developing countries, then the figures on net resource transfers shown in Annex Table 1 taken from [Gwin *et al.* (1989), p. 105], reveals a very interesting trend.

Aid flows from the official and private creditors to the heavily indebted countries is negative particularly from 1984 onwards. It appears that the developing world is generating enough surpluses to pay off its creditors – resources are now flowing in the opposite direction. So much for aid bringing about a real transfer of resources from the developed to the developing world.

## Annexure

Annex Table 1

*Net Resource Transfers from Official and Private Creditors to the Heavily Indebted Countries, 1980-87*

(\$ Million)

Net Resource Transfers	1982	1983	1984	1985	1986	1987
<b>Official Creditors</b>						
IMF	2,320	6,518	3,325	1,671	-275	-1,383
World Bank, IDA	921	1,398	1,597	949	1,078	-557
Other	1,866	1,204	9,276	2,304	580	-2,344
<b>Private Creditors</b>						
Suppliers	522	1,009	-432	-254	-301	-60
Financial Markets	5,780	-3,785	-10,449	-18,375	-19,096	-14,106
Sub-total	6,201	-2,861	-10,950	-18,670	-19,429	-14,198
<b>Total</b>	<b>11,308</b>	<b>6,343</b>	<b>-1,674</b>	<b>-16,366</b>	<b>-18,848</b>	<b>-16,542</b>

*Source:* World Bank Debt Tables, 1988-89, Volume 11, Analysis and Summary Tables, "Highly Indebted Countries," pp.30-31. Note that "net resource transfer" is defined as net flows minus total interest payments for all creditors except the IMF. For the IMF, "net resource transfer" is defined as the IMF purchases minus repurchases.

## REFERENCE

Gwin, Catherine *et al.* (1989) *The International Monetary Fund in a Multipolar World: Pulling Together*. New Brunswick (USA) and Oxford (UK): Transaction Books.

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