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The Political Economy of Foreign Aid: Fatigue or Regeneration?

Graham Bird*

Surrey Centre for International Economic Studies, University of Surrey

Abstract: The purpose of this paper is to explain recent changes in aid provision by examining both the economics and politics that lie behind them. Within the context of an analysis of the political economy of foreign aid, it is then possible to say whether aid fatigue is likely to persist, or whether it is reasonable to expect a regeneration of aid as a consequence of increasing knowledge about how it works and changing political imperatives.

JEL Clasification: F34, O1

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Introduction

Since the early 1990s there has been a pronounced fall in the real amount of foreign aid provided by donors for developing countries. Over the same period, while progress has been made in some parts of the developing world, Africa, a region which has relied heavily on aid flows, has witnessed little if any reduction in poverty. Indeed, the number of people living in poverty world-wide is likely to rise in the remaining years of the 20th century. On the face of it aid is being withdrawn when it is still desperately needed.

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* Graham Bird is Professor of Economics at the School of Human Sciences and Director of Surrey Centre for International Economic Studies , University of Surrey, Guildford, UK.

But is foreign aid effective in alleviating poverty? If not, reducing it may be the sensible thing to do. If there are no developmental returns, why incur the cost?

Foreign Aid: The Empirical Picture

A number of significant trends in foreign aid may be gleaned from the Tables provided in this Section, all of which are drawn from the OECD's *Development Co-operation Report*, 1996, the IMF's *Official Financing for Developing Countries*, 1998, and *Global Development Finance* 1998, published by the World Bank. Table 1 shows that Official Development Assistance (ODA) fell from US$62.7 billion in 1991 to US$34.7 billion in 1996. Bilateral ODA, which represents two thirds of all official flows, dropped 7 per cent in real terms and 10 per cent in nominal terms in 1996. A 16 per cent increase in multilateral aid in real terms only partially offset the decline in bilateral assistance. Not surprisingly, given the positive growth performance amongst OECD countries, aid as a percentage of donors' GNPs fell to an average of 0.25 per cent in 1996, the lowest for thirty years. Data in Table 2 provide a breakdown by donor over the period 1980-95. During the 1980s, the aid/GNP ratio had been roughly constant at about 0.34 or 0.33 per cent; economic growth in donor countries implied a related growth in real aid over this period.

Declining foreign aid in the 1990s has not been replaced by grants by non-governmental organisations (NGOs). These had risen quite sharply between 1987 and 1992 but levelled off thereafter, falling in real terms. By 1995 such grants stood at slightly less than 10 per cent of ODA. Was anything taking the place of declining aid and charitable giving? Private flows have been the principal source of growth in net financial flows to developing countries during the 1990s. This represented a dramatic reversal from the 1980s, when, in the aftermath of the Third World debt crisis, private flows fell significantly, failing to recover to even their 1980 level by 1990; over this period, aid had been of increasing relative importance. Private flows that had represented a modest 39 per cent of total net resource flows to developing countries in 1989, accounted for about 88 per cent in 1996. In terms of the external financing of developing countries, the 1990s have witnessed a massive overall move to the market caused by a combination of increasing private lending and declining aid flows.

Overall figures can, of course, be misleading and this is true of the aid data presented above. As revealed by Table 2, not all DAC countries have allowed their aid-to-GNP ratios to decline during the 1990s; but either the increases have been small, such as in the UK's case, or the countries are insignificant donors in absolute terms. The dominant absolute change has been the sharp decline in US aid, although significant falls have also occurred in Canada, Germany, Italy, Japan, the

Table 1.: Net Resource Flows to Developing Countries

	Current $ billion									Per cent of total		
	1987	1988	1989	1990	1991	1992	1993	1994	1995p	1987	1989	1995
I OFFICIAL DEVELOPMENT FINANCE (ODF)	**56.7**	**61.4**	**61.1**	**69.8**	**69.7**	**69.8**	**70.1**	**71.6**	**69.4**	**66.1**	**52.7**	**28.3**
1. Official development assistance (ODA)[a]	43.9	47.9	49.0	52.9	58.6	58.9	56.4	60.5	60.1	51.2	42.2	24.7
of which: Bilateral disbursements	34.0	36.8	36.6	39.4	42.4	41.4	39.6	41.3	40.6	39.6	31.6	16.0
Multilateral disbursements	9.9	11.1	12.4	13.5	16.2	17.5	16.8	19.2	19.5	11.5	10.7	8.7
2. Other ODF	12.8	13.5	12.1	16.9	11.1	10.9	13.7	11.1	9.3	14.9	10.4	3.6
of which: Bilateral disbursements	6.2	7.0	5.3	6.7	4.4	7.4	6.4	7.5	5.0	7.2	4.6	2.0
Multilateral disbursements	6.6	6.5	6.8	10.2	6.7	3.5	7.3	3.6	4.3	7.7	5.9	1.6
II TOTAL EXPORT CREDITS	**-1.6**	**-2.2**	**9.4**	**4.7**	**1.8**	**1.3**	**-0.6**	**9.3**	**11.0**	**-1.9**	**8.1**	**4.3**
of which: Short-term	4.1	2.0	4.8	4.5	-0.8	0.5	-1.5	0.2	0.8	4.8	4.1	0.3
III PRIVATE FLOWS	**30.7**	**39.1**	**45.5**	**51.8**	**50.8**	**76.8**	**86.4**	**134.1**	**158.9**	**35.8**	**39.2**	**67.4**
1. Direct investment (DAC)	19.4	21.8	26.5	26.4	22.6	27.3	38.6	48.5	53.6	22.6	22.8	23.7
of which: to offshore centres	10.9	8.9	6.5	7.1	6.5	9.5	9.5	9.1	9.0	12.7	5.6	3.6
2. International bank lending[b]	7.0	7.8	10.5	15.0	11.0	31.0	9.0	42.6	70.0	8.2	9.1	29.6
of which: short-term	5.0	4.0	8.0	7.0	12.0	25.0	7.0	44.0	50.0	5.8	6.9	27.7
3. Total bond lending	-1.0	1.6	2.2	0.9	6.5	11.1	29.0	29.0	19.3	-1.2	1.9	7.6
4. Other private[c]	1.3	3.7	2.3	4.4	5.3	1.4	4.0	8.0	10.0	1.5	2.0	4.0
5. Grants by non-governmental organisations	4.0	4.2	4.0	5.1	5.4	6.0	5.8	6.0	6.0	4.7	3.4	2.4
TOTAL NET RESOURCE FLOWS (I + II + III)	**85.8**	**98.3**	**116.0**	**126.3**	**122.3**	**147.8**	**155.9**	**215.0**	**239.3**	**100.0**	**100.0**	**100.0**
At 1994 prices and exchange rates:												
Total net resource flows	114.3	121.5	144.8	141.4	132.2	150.8	162.5	215.0	218.5			
Total official development finance	75.5	75.9	76.3	78.1	75.4	71.2	73.1	71.6	63.4			
Total ODA receipts	58.5	59.2	61.2	59.2	63.4	60.1	58.8	60.5	54.9			
Total DAC ODA (bilateral and multilateral)	54.1	58.2	57.1	59.3	61.3	62.1	58.9	59.2	53.6			

[a] Excluding forgiveness of non-ODA debt for the years 1990 to 1992

[b] Excluding bond lending by banks (item III.3), and guaranteed financial credits (included in II).

[c] No reporting has been received from DAC Members on portfolio investment.

Netherlands, Norway and Sweden. In 1992 the US provided US$11,709 million of ODA, placing it as the largest single aid donor. By 1995 US aid had fallen to US$7,367 million in current prices, below the aid disbursements of Japan, France and Germany. Aid fatigue is exemplified by the US.[1]

At the same time, and re-enforcing these trends, aid flows from non-DAC countries had become almost completely insignificant by the mid-1990s accounting for only about US$1,000 million in 1995. Saudi Arabian aid, for example, fell from US$1,700 million in 1991 to US$192 million in 1995.

But has the decline in ODA been accompanied by any change in its distribution? Table 3 provides data on this, showing that over 1984/85 - 1994/95 there was indeed a redistribution of aid away from Asia and the Middle East and North Africa, and towards Sub-Saharan Africa; the redistribution towards SSA is part of a longer run trend which has been in place since the mid-1970s. The share of aid going to Latin America and the Caribbean has remained fairly constant. At the same time even the regions that have benefited most from the redistribution of aid have received less aid as a percentage of their GNPs since the beginning of the 1990s. Aid-reliance in Sub-Saharan Africa (SSA), for example, fell from 22.4 per cent in 1989-90 to 7.8 per cent in 1994-95. However, the reliance of most of SSA (as well as other low income developing countries), on aid as compared to private flows, remains undiminished. In large measure private capital flows have by-passed the poorest countries and have been heavily skewed to a relatively small group of better-off Latin American and Asian developing countries. For these countries private capital has not replaced foreign aid.

Relevant in the context of the redistribution of foreign aid is the fact that the so-called CEEC and NIS countries (Central and Eastern European Countries and New Independent States of the former Soviet Union) now form a new category of aid recipients. In 1995 they received aid flows of over US$9,000 million, i.e. about 0.04 per cent of the GNP of DAC countries and about 15 per cent of total aid to developing countries. The largely unjustified concern that countries in transition would 'crowd out' developing countries from private capital markets (Collins, 1993), should perhaps have been more appropriately directed towards aid, where there apparently has been a significant degree of crowding out. US aid is somewhat replenished when flows to CEEC/NIS countries are included, but even so the US aid budget declined sharply, and still showed 'aid fatigue'.

But why have donors suffered from aid fatigue? Is it born out of frustration that aid has not delivered its promises? Perhaps the benefits as perceived by donors have not outweighed the costs, with the result that aid is increasingly seen as an inefficient use of donors' resources. What has caused these changed perceptions?

Before moving on to examine these questions, a prior question is whether the decline in foreign aid shown above reflects aid's success in reducing world-wide

Table 2.: ODA Performance of DAC Countries in 1995 and Recent Years

	$ millions			Per cent of GNP						Change in percentage 1995/94			
	1995 actual[a]	1994 actual[a]	1995 volume[b]	1980/84 average	1985/89 average	1994/95 average	1993	1994	1995	In national currency	In $	In volume terms[b]	Annual average % change in volume[b] 1989/90-1994/95
Australia	1194	1091	- 1148	0.48	0.42	0.35	0.35	0.34	0.36	7.9	9.4	5.2	2.5
Austria	767	655	663	0.29	0.23	0.33	0.30	0.33	0.33	3.3	17.0	1.2	9.3
Belgium	1034	726	894	0.56	0.46	0.35	0.39	0.32	0.38	25.5	42.4	23.1	-3.9
Canada	2067	2250	2042	0.45	0.47	0.40	0.45	0.43	0.38	-7.7	-8.1	-9.2	-0.6
Denmark	1623	1446	1409	0.76	0.89	0.99	1.03	1.03	0.96	-1.1	12.2	-2.6	3.3
Finland	388	290	314	0.29	0.54	0.32	0.45	0.31	0.32	11.9	33.9	8.1	-14.5
France	8443	8466	7437	0.53	0.59	0.59	0.63	0.64	0.55	-10.4	-0.3	-12.2	0.8
Germany	7524	6818	6509	0.46	0.41	0.32	0.36	0.34	0.31	-2.5	10.3	-4.5	-0.9
Ireland	153	109	141	0.20	0.21	0.27	0.20	0.25	0.29	31.3	40.8	29.7	17.4
Italy	1623	2705	1554	0.20	0.37	0.21	0.31	0.27	0.15	-39.4	-40.0	-42.6	-9.7
Japan	14489	13239	13396	0.31	0.31	0.28	0.27	0.29	0.28	0.8	9.4	1.2	0.2
Luxembourg	65	59	56	0.20	0.18	0.38	0.35	0.40	0.36	-2.9	10.1	-5.9	14.4
Netherlands	3226	2517	2789	1.01	0.97	0.79	0.82	0.76	0.81	13.1	28.2	10.8	-0.8
New Zealand	123	110	109	0.28	0.26	0.23	0.25	0.24	0.23	1.2	12.0	-1.2	2.7
Norway	1244	1137	1087	0.97	1.09	0.95	1.01	1.05	0.87	-1.7	9.5	-4.4	1.1
Portugal	271	308	231	0.03	0.16	0.31	0.29	0.35	0.27	-20.7	-12.2	-25.0	8.3
Spain	1348	1305	1198	0.09	0.10	0.26	0.28	0.28	0.24	-3.8	3.3	-8.2	10.1
Sweden	1704	1819	1513	0.85	0.89	0.86	0.99	0.96	0.77	-13.4	-6.3	-16.8	-1.8
Switzerland	1084	982	924	0.27	0.31	0.35	0.33	0.36	0.34	-4.6	10.3	-5.9	3.0
United Kingdom	3157	3197	2990	0.37	0.31	0.29	0.31	0.31	0.28	-4.2	-1.3	-6.5	1.8
United States	7367	9927	7187	0.24	0.20	0.12	0.15	0.14	0.10	-25.8	-25.8	-27.6	-4.4
Total DAC	**58894**	**59156**	**53590**	**0.34**	**0.33**	**0.28**	**0.30**	**0.30**	**0.27**	**-7.8**	**-0.4**	**-9.4**	**-0.9**
of which EU Members	31478	30420	27697	0.44	0.45	0.40	0.44	0.42	0.38	-6.2	3.5	-9.0	-0.6

[a] At current prices and exchange rates

[b] At 1994 exchange rates and prices

Table 3.: Total Net Receipts of ODA by Region and Selected Developing Countries (continued overleaf)

	Per cent of total ODA			Per cent of DAC bil. ODA	Share in total population	ODA receipts		ODA as a percentage of LDCs' 1994 GNP		GNP per capita[a] ($) 1994
	1984-85	1989-90	1994-95	1995	(%) 1995	$ billion 1995	Annual real % change 1985-95	1989-90	1994-95	
SUB-SAHARAN AFRICA	**29.6**	**35.9**	**36.7**	**37.2**	**13.0**	**18.2**	**0.0**	**22.4**	**7.8**	..
of which:										
Côte d'Ivoire	0.4	1.2	2.8	2.4	0.3	1.2	18.0	11.7	25.7	610
Zambia	1.0	0.9	2.7	4.1	0.2	2.0	12.3	26.8	42.6	350
Mozambique	1.1	2.1	2.3	2.2	0.4	1.1	4.4	156.7	95.7	90
Ethiopia	2.2	2.0	1.9	1.8	1.2	0.9	-5.9	30.7	20.9	100
Tanzania	1.8	2.3	1.8	1.8	0.7	0.9	-1.1	69.3	-	140
Uganda	0.6	1.2	1.5	1.6	0.4	0.8	8.4	-	19.8	190
Rwanda	0.6	0.6	1.4	1.4	0.2	0.7	7.1	24.5	123.1	80
Kenya	1.4	2.4	1.4	1.4	0.6	0.7	-1.7	25.7	10.7	250
Ghana	0.7	1.4	1.2	1.3	0.4	0.6	5.5	22.5	11.2	410
Cameroon	0.6	1.0	1.2	0.9	0.3	0.4	4.1	7.9	8.6	680
Zimbabwe	0.9	0.7	1.0	1.0	0.2	0.5	0.2	9.9	10.3	500
Somalia	1.2	1.0	0.7	0.4	0.2	0.2	-12.1	-	-	..
Sudan	3.0	1.7	0.6	0.5	0.6	0.2	-20.5	14.7	-	..
Madagascar	0.6	0.8	0.6	0.6	0.3	0.3	-2.3	29.2	16.1	200
Congo	0.3	0.3	0.5	0.3	0.1	0.1	0.7	14.9	21.0	620
Zaire	1.0	1.7	0.4	0.4	1.0	0.2	-10.8	19.5	-	..
Nigeria	0.1	0.6	0.4	0.4	2.4	0.2	12.7	1.9	0.6	280
Eritrea	-	-	0.3	0.3	0.1	0.1	-	-	-	..
ASIA	**32.1**	**31.7**	**30.7**	**30.4**	**68.9**	**14.9**	**-2.3**	**2.2**	**0.7**	..
of which:										
China	2.9	4.5	6.7	7.2	27.0	3.5	6.8	1.0	0.7	530
India	5.6	3.4	4.0	3.5	20.7	1.7	-5.9	1.1	0.7	320
Indonesia	2.0	3.7	3.0	2.8	4.3	1.4	2.4	3.7	0.9	880
Bangladesh	4.0	4.2	3.0	2.6	2.7	1.3	-5.5	17.9	5.8	220
Pakistan	2.3	2.5	2.4	1.6	2.9	0.8	-4.7	5.6	2.3	430
Philippines	1.4	2.2	1.9	1.8	1.5	0.9	-0.1	4.8	1.5	950
Thailand	1.6	1.6	1.4	1.8	1.3	0.9	-0.3	2.1	0.5	2410
Sri Lanka	1.6	1.4	1.1	1.1	0.4	0.6	-4.9	17.7	5.0	640

Continued overleaf

(Continued from the last page)

	Per cent of total ODA			Per cent of DAC bil. ODA	Share in total population	ODA receipts		ODA as a percentage of LDCs' 1994 GNP		GNP per capita[a] ($) 1994
	1984-85	1989-90	1994-95	1995	(%) 1995	$ billion 1995	Annual real % change 1985-95	1989-90	1994-95	
OCEANIA	**2.6**	**2.7**	**3.0**	**3.3**	**0.1**	**1.6**	**1.1**	**47.6**	**19.8**	..
NORTH AFRICA AND MIDDLE EAST	**21.3**	**16.9**	**13.3**	**11.3**	**5.7**	**5.5**	**-8.1**	**2.5**	**1.3**	..
of which:										
Egypt	5.7	7.5	4.6	4.1	1.3	2.0	-4.8	21.8	5.6	720
Israel	5.5	2.7	1.6	0.7	0.1	0.3	-21.6	5.3	1.0	14530
Morocco	1.9	1.6	1.1	1.0	0.6	0.5	-10.5	6.6	1.9	1140
Syria	2.7	0.8	1.1	0.7	0.3	0.3	-12.8	5.6	-	..
Jordan	2.1	1.2	0.9	1.1	0.1	0.5	-6.5	25.4	7.8	1440
Yemen	1.6	0.8	0.3	0.4	0.3	0.2	-15.1	10.3	4.7	280
Tunisia	0.6	0.7	0.2	0.1	0.2	0.1	-13.9	6.2	0.6	1790
LATIN AMERICA	**13.1**	**10.9**	**12.0**	**13.2**	**10.7**	**6.5**	**-2.0**	**1.2**	**0.4**	..
of which:										
Bolivia	0.6	1.1	1.3	1.4	0.2	0.7	6.1	23.5	11.9	770
Peru	1.0	0.8	0.8	0.9	0.5	0.4	-3.6	3.2	0.9	2110
Mexico	0.4	0.3	0.8	0.8	2.1	0.4	3.0	0.1	0.1	4180
El Salvador	0.9	0.8	0.7	0.8	0.1	0.4	-2.4	17.9	12.2	600
Honduras	1.0	0.8	0.6	0.6	0.1	0.3	-7.6	14.6	3.8	1360
Costa Rica	0.8	0.5	0.1	0.1	0.1	0.0	-26.5	9.0	0.6	2400
SOUTHERN EUROPE	**1.3**	**1.8**	**4.4**	**4.6**	**1.5**	**2.3**	**12.1**	**1.1**	**1.7**	..
of which:										
Turkey	0.7	1.4	0.5	0.6	1.4	0.3	-0.6	1.6	0.2	2500
Cyprus	0.1	0.1	0.1	0.0	0.0	0.0	-10.7	1.4	-	..
OVERALL TOTAL	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**49.0**	**-2.0**	**3.0**	**0.9**	..

[a] World Bank Atlas basis

Note: Net ODA from DAC Members and DAC Member-financed multilateral organisations. Excluding amounts not allocated by country.

Table 4.: Population living below US$1 a day in developing and transitional economies, 1987-1993

Regions	Population covered by at least one survey (percent)	Number of poor (millions)			Headcount index (percent)			Poverty gap (percent)		
		1987	1990	1993	1987	1990	1993	1987	1990	1993
East Asia and the Pacific	88.0	464.0	468.2	445.8	28.2	28.5	26.0	8.3	8.0	7.8
(excluding China)	(61.5)	(109.2)	(73.5)	(73.5)	(23.2)	(17.6)	(13.7)	(3.8)	(3.1)	(3.1)
Eastern Europe and Central Asia	85.9	2.2	n.a	14.5	0.6	n.a	3.5	0.2	n.a	1.1
Latin America and the Caribbean	83.9	91.2	101.0	109.6	22.0	23.0	23.5	8.2	9.0	9.1
Middle East and North Africa	46.7	10.3	10.4	10.7	4.7	4.3	4.1	0.9	0.7	0.6
South Asia	98.4	479.9	480.4	514.7	45.4	43.0	43.1	14.1	12.3	12.6
sub Saharan Africa	65.9	179.6	201.2	218.6	38.5	39.3	39.1	14.4	14.5	15.3
Total	85.0	1227.1	n.a	1313.9	30.1	n.a	29.4	9.5	n.a	9.2
Total (excluding ECA)	85.0	1224.9	1261.2	1299.3	33.3	32.9	31.8	10.8	10.3	10.5

n.a.: Not available

Note: These estimates revise and update those in *Implementing the World Bank's Strategy to Reduce Poverty* (World Bank 1933b). There are a number of differences between these numbers and previous estimates, including those in *World Development Report 1990*. New household surveys have become available; a total of 122 surveys for sixty-seven countries were used in constructing the above estimates. They also incorporate new estimates of PPP exchange rates for converting US$1 per day (in 1985 prices) into local currencies. And the numbers are estimated from those countries in each region for which at least one survey was available during the period 1985-94. The proportion of the population covered by such surveys is given in column 1. Survey dates often do not coincide with the dates in the above table. To line up with the above dates, the survey estimates were adjusted using the closest available survey for each country and applying the consumption growth rate from national accounts. Using the assumption that the sample of countries covered by surveys is representative of the region as a whole, the numbers of poor are then estimated by region. This assumption is obviously less robust in the Middle East and African regions. The headcount index is the percentage of the population below the poverty line. The poverty gap index is the mean distance below the poverty line (zero to the nonpoor) expressed as a percentage of the poverty line.

poverty. Is aid no longer needed? The data in Table 4 show that this is not the case. While the incidence of poverty throughout the world fell slightly over 1987-1993, the number of people living in poverty has increased. In its recent report on *Poverty Reduction*, from which the Table is taken, the World Bank tellingly describes the situation in the following terms, 'poverty reduction is the most urgent task facing humanity today' (p. vii). But if poverty reduction remains 'urgent' why have donors been *reducing* their aid flows?

The Economics of Aid and Its Effectiveness: Fatigue Sets In

Early economic analysis of aid was built on the premise that development and poverty-reduction ultimately depend on economic growth. In principle, therefore, the main focus of foreign aid was placed on its role in encouraging economic growth in developing countries. In seeking to explain economic growth development economics took as its starting point the Harrod-Domar growth model. This may be summarised briefly by the fundamental growth equation $g = s/v$, where g is the rate of economic growth, s is the domestic savings ratio, and v is the incremental capital-output ratio (ICOR), reflecting the marginal productivity of capital. The model says that in order to achieve a specific or targeted rate of economic growth at a given and constant marginal productivity of capital a country needs a specific amount of investment and therefore a specific amount of savings to finance the investment. To the extent that domestic savings fall short of this level, foreign aid can help by filling the savings gap.

An extension to the analysis introduced the idea that problems could still exist and economic growth could still be frustrated, even where a country generated sufficient domestic savings, if it proved impossible to convert excess savings into the foreign exchange earnings necessary to finance development-related imports (often capital goods). As well as the savings gap there was also, therefore, a foreign exchange gap measuring the gap between the foreign exchange needed to finance imports and the foreign exchange earned through exports. There were, in other words, two gaps; hence 'dual gap' analysis (Chenery and Strout, 1966). Foreign aid played a twin role in helping to close both gaps. Where it was shortfalls in domestic savings and foreign exchange earnings that were the effective constraints on economic growth, the conclusion was drawn that foreign aid would relax these constraints and foster economic growth. Much of the theoretical justification for foreign aid has remained loosely based on dual gap analysis ever since.

However, the dual gap model provides a less than perfect basis for analysing foreign aid. First, it has become accepted that economic growth is not synonymous with economic, social and human development. Countries may grow according to economic measures, but still fail to develop. The view that economic growth alone ensures that more widely defined developmental objectives will be attained has been rejected. Economic growth remains important, even necessary, but not sufficient.

Second, dual gap analysis rests on a number of restrictive assumptions which have been shown to be unrealistic in many developing countries. Early criticism of the model had identified its implicit rigidities that tended to understate the role that developing countries themselves had in fostering economic development and to overstate the role of foreign aid. Over time these deficiencies have become more apparent. Clearly to the extent that there is scope for increasing domestic savings and increasing the productivity of investment, the need for foreign aid can be reduced. At the same time foreign aid (imported saving) may 'crowd out' domestic saving and be used to finance investment projects which have a lower than average productivity. Where, in practice, foreign aid induces a fall in the domestic savings ratio and an increase in the incremental capital-output ratio (ICOR), it will fail to have the anticipated positive effect on the rate of economic growth.

Inflexibility also seemed to exist in the context of the foreign exchange constraint, where dual gap analysis downplayed the scope for using exports as a way of substituting domestic resources into imports. Export growth offers a potential way of closing the foreign exchange gap, and critics of dual gap analysis claimed that it was through this route that excess domestic labour supply could be substituted into scarce foreign capital goods without the need for foreign aid. Essentially the criticism was that dual gap analysis was unduly pessimistic about the prospects for export expansion in developing countries, which could be enhanced by policies aimed at diversification and the exchange rate.

Subsequent economic analysis has tended to concentrate, in some detail, on the behavioural responses of recipients to foreign aid inflows. A compelling critique of foreign aid can be assembled if it can be shown that it finances current consumption rather than investment, it finances unproductive government expenditure which then crowds out private investment with a higher productivity, it is 'fungible' and is used to replace the domestic development budget and to finance government fiscal deficits associated with increased current expenditure, it results in appreciating real exchange rates, which discourage exports and encourage imports (Dutch disease), worsening current account balance of payments deficits, and it generally creates the wrong set of incentives, not only in relation to relative prices, exchange rates and interest rates, but also by creating a moral hazard in terms of encouraging governments to postpone necessary, but politically costly, adjustment. Over the years there has been accumulating evidence to suggest that these are real rather than purely hypothetical problems.[2]

Moreover, to the extent that the dangers are real, they suggest that foreign aid will fail to have a significant positive impact on economic growth; this is indeed what, until recently, the available macroeconomic evidence has shown. Numerous studies have failed to discover any statistically significant causal relationship between aid and economic growth, in spite of the fact that studies of aid-effectiveness at the micro level have, again until recently, shown a generally satisfactory rate of return.[3] Typical of the mid-1990s consensus on aid-effectiveness, Boone (1996) argues that the empirical evidence supports the claim that aid neither fosters economic growth, nor benefits the poor as measured by improvements in human development indicators. It does not increase investment, but, in effect, is simply used to finance increased current consumption. While it is possible that the methodologies of measurement are deficient, over-estimating the micro returns and under-estimating the macroeconomic returns (White, 1992), the inconsistency between the micro and macro evidence on aid-effectiveness can also clearly be explained by the fact that micro effectiveness studies hold 'other things' constant. The existence of the micro-macro paradox therefore itself implies that aid has adverse effects in terms of reducing domestic savings and investment, fungibility, Dutch disease, and moral hazard.

Evidence that foreign aid fails to foster economic growth in developing countries also undermines, at source, the argument that it is to the mutual advantage of recipients and donors (Brandt, 1980). The essence of this argument is that, via its effects on economic growth in recipients, foreign aid increases the demand for exports from the donors that then benefit from export-led growth and the related increases in output and decreases in unemployment. Leaving to one side the fact that the 'mutuality doctrine' rests strongly on a somewhat unfashionable neo-Keynesian view of how the world economy works, it loses credibility almost totally if aid is found to be ineffective at generating economic growth in aid-recipients.

Aid which finances current consumption rather than investment may of course alleviate short term poverty; aid has an humanitarian role. Even if ineffective in raising economic growth, aid could have been successful in reducing poverty. Again there are methodological problems here associated with the counter-factual; what would have happened had aid not been provided? However, the weight of evidence on the poverty-reducing effects of aid is not strongly supportive of it either. Most studies that have examined the subject conclude that aid does not seem to help the poorest people in aid-receiving countries.[4] Moreover, the data in Table 3 show that poverty in Africa, a region that has received large and increasing amounts of aid, remains endemic,[5] and, as reported earlier, Boone (1996) finds no statistical link between aid and human development indicators. If aid was promulgated in the belief that it would significantly reduce poverty, frustration with its apparent inability to do so could clearly be a source of aid fatigue.

Another important element in the evolving economics of foreign aid also helps to explain why aid fatigue set in. In the context of dual gap analysis the case for aid rests on the twin assumptions that first, financing gaps exist, and second, they will not be filled by private international capital markets. It is not coincidental therefore that aid flows fell in the first half of the 1990s at the same time as private flows were rising. At the aggregate level much of the task of financing economic development appeared (misleadingly) to have been taken over by private capital markets, suggesting that foreign aid was no longer needed (Lal, 1996).

Based on a model that is theoretically deficient, surrounded by empirical evidence that suggests that it is ineffective in achieving its economic and humanitarian objectives, and with its financing role apparently having been taken over by private capital markets, it is easy to see why the economic case for aid has been seen to become weaker, and why donors have suffered from aid fatigue. But is the perception accurate? Have things changed? It would be ironic if aid donors started to cut aid budgets at precisely the same time as evidence is beginning to emerge that aid has become more effective. Does such evidence exist? Before going on to examine this question, aid fatigue in the mid-1990s needs to be investigated from a political perspective.

The Politics of Foreign Aid Fatigue

Attempts to explain the distribution of aid have frequently distinguished between 'recipient needs' and 'donor interests' (Grilli and Reiss, 1992, Burnside and Dollar, 1997). The consensus emerging from econometric studies confirms what an eye-balling of the data linking individual donors with individual recipients suggests, namely that donor interests have dominated.[6] These may be commercial, although the historical evidence is that political and military factors have generally been more prominent. In substantial part, foreign aid has been a political phenomenon. If so, it is reasonable to assume that changing politics lie at the heart of changing aid flows. It is also reasonable to assume that the politics of aid may have undermined its effectiveness in terms of economic growth and poverty reduction (Boone, 1996, Burnside and Dollar, 1996).

But has foreign aid been any more effective at achieving its political objectives? The empirical evidence suggests not (Mosley, 1987). Aid has been an inefficient way of buying political influence, and this provides another explanation of aid fatigue.

Probably more significant, however, have been the huge global political changes which there have been during the 1990s. First, the ties of colonialism have loosened. However, the evidence does not suggest that this is an important factor. Former colonial powers such as the UK and France remain quantitatively significant aid donors, and much of their aid still goes to former colonies.[7]

Second, and much more importantly, there has been the fall of Communism and the end of the Cold War. This explanation appears to fit the fact that the discrete shift in the size of foreign aid happened in 1992. The Cold War explanation of changing aid flows has a number of dimensions. First, Western countries have no longer felt the need to provide aid as a means of discouraging the spread of Communism. There is no longer a 'foreign aid war' in which the East and West attempt to outbid each other in buying influence. Second, COMECON has ceased to be an aid donor. Third, and at the same time as the CEEC/NIS have stopped being donors they have started being recipients. The thawing of the Cold War has therefore had a double-edged effect on the size and pattern of aid flows, by eliminating donors and creating a new group of recipients.

Combined with the Cold War effect, the changing political economy of OECD countries, along with changing economic priorities, has made them less willing to give aid. Although predating the fall in aid, there has been a general and downward reassessment of what governments can achieve. A more recent development has been the strong desire to reduce fiscal deficits. This was an acute political issue in the US in the mid-1990s where a Democratic President vied with a Republican-dominated Congress to eliminate the US fiscal deficit. But similar pressures have been experienced within Europe, especially where members of the European Union have been anxious to guarantee their eligibility to participate in a single currency as part of Economic and Monetary Union. With the Maastricht convergence criteria stipulating a maximum fiscal deficit of 3 per cent of GDP, and maximum government debt of 60 per cent of GDP, European countries have been forced to reassess all aspects of government expenditure.

Foreign aid constitutes a lower political priority than health, social security, state pensions, and unemployment benefit. High levels of unemployment in Europe, along with demographic changes which have put increasing pressure on domestic elements of government expenditure have therefore made the political climate much less conducive to aid, which has been perceived to carry a higher opportunity cost. It is difficult for governments that are cutting politically sensitive domestic expenditure to leave the foreign aid budget intact.

In as much as aid is still politically motivated, the politics has shown itself in the form of an interest in human rights, civil liberties, and corruption in aid recipients. But these represent weak motivational forces for aid as compared with strategic political or military objectives. While in the long run a lack of human rights in aid-receiving countries may be a source of political instability, and this could affect a donor's strategic self-interests, such matters are difficult to calculate with precision. Indeed donors have in the past sometimes acted as if they favour strong authoritarian regimes. With the associated uncertainty, and given the long term time frame, donors probably discount quite heavily the destabilising effects of human rights abuse, although such abuses provide a ready and convenient way of justifying aid reductions.

If donors have perceived the political opportunity cost of aid to rise, and the benefits to decline, it is not difficult to see why aid fatigue has crept in. Since the perceived benefits of aid, in terms of humanitarian and economic returns, will be approximately shared by all donors, differences in donor behaviour can be ascribed primarily to differences in the underlying politics. In this context it is not surprising that with the thawing of the Cold War, with less generous welfare programmes than in Europe, and a culture which is less supportive of state intervention, the cut in aid budgets has been particularly sharp in the United States.

In a political environment that is generally unfavourable to aid, the misgivings about its economic and humanitarian effectiveness provide further public legitimisation. Moreover, the humanitarian arguments for aid can be countered by governments referring to its poor record in terms of poverty alleviation, and by focusing more heavily on the role of NGOs as the appropriate means for providing humanitarian assistance. On top of this, there is always the argument that aid is globally regressive, taxes paid by relatively poor people in relatively rich countries finance aid which goes to relatively rich people in relatively poor countries. Given the degree of income inequality in many developing countries, as well as the evidence that aid tends not to reach the poorest sectors in society, this remains a compelling point.

But does all this mean that the politics are stacked against any regeneration of foreign aid? If so, why did the UK Government in 1997 produce a White Paper setting itself ambitious aid targets? Perhaps the politics as well as the economics are changing.

From Fatigue to Regeneration

So far this paper has provided an explanation of the decline in foreign aid flows in the first half on the 1990s based on a combination of economics and politics. But how long will fatigue last? And are there forces at work that may regenerate foreign aid?

Aid Regeneration: the Economics

As noted earlier economic growth is a necessary condition for sustained improvement in human development. In the past, however, foreign aid has been analysed within the context of a very rudimentary growth model. During the last ten years or so growth theory has itself been a growth industry and, albeit gradually, a better understanding of the determinants of economic growth is emerging. With this, it will become clearer where aid can make a positive contribution.

New growth theory, for example, suggests that aid should be directed at increasing productivity (partly by enhancing technology transfer), and at improving the stock of human capital through education, training and health; areas where private capital markets may be inefficient. New research claims to have identified robust connections between the nature of economic systems and economic growth, implying that liberalisation, particularly in the form of open trading relationships, have a beneficial long run effect on economic growth (Sachs and Warner, 1995, 1997, and Edwards, 1998). This clearly carries lessons with it for the design of aid policies.

More directly two recent studies have identified a significantly positive effect of foreign aid on economic growth as well as on other indicators of human development. One of these studies has been published by the World Bank (Burnside and Dollar, 1997) which suggests that previous evidence failed to pick up a positive effect because it included all aid recipients together. Burnside and Dollar distinguish between those aid recipients that have pursued sound macroeconomic policies as proxied by open trade regimes, fiscal discipline, and the avoidance of high inflation and those that have not. Although aid is shown to be ineffective in the countries where domestic policy has been unsound, it has been effective in those with good domestic policies, raising economic growth above (and reducing infant mortality below) levels that would previously have been expected. The beneficial effect of aid is particularly marked for low income countries. Over the period 1970-1993, Burnside and Dollar find that amongst low income countries with good policies those with large amounts of aid enjoyed annual per capita income growth of 3.5 per cent as compared with 2.0 per cent growth for those with only small amounts of aid. Foreign aid significantly increased the rate of return (by about 30 per cent) to good domestic economic policies. Thus Burnside and Dollar report, "a robust finding that aid has a positive impact on growth in a good policy environment".(p. 33)[8]

The second study by Mosley and Hudson (1997) is compelling particularly as it comes from researchers who have previously discovered no significant effect of aid on growth (Mosley, 1987). Indeed even in this study they only find a significantly positive effect when they divide their sample into two sub-periods. It is only since the early 1980s that aid seems to have been effective in stimulating economic growth. But why? Mosley and Hudson offer an explanation that is consistent with Burnside and Dollar's finding. They claim that the relationship between aid and growth underwent a structural change in the early 1980s. Essentially, the factors that had previously accounted for the micro-macro paradox (with the exception of the negative effect of aid on domestic savings) have become less significant since then. In particular, the decline in domestic development budgets has made foreign aid much less fungible; aid recipients have been less able to substitute foreign aid for domestic expenditure on development. They also point out that the increased effectiveness of aid coincided with the shift to conditional policy-based lending by the World Bank, and an increasing policy dialogue. Where the policies favoured by the Bank have been implemented there is a reasonable presumption that the recipient will have been pursuing sound policies as measured by Burnside and Dollar. [9]

It is also interesting that they find a positive coefficient of aid on economic growth over a period of time when the data in section 2 show that aid was being more heavily directed to low income developing countries where growth prospects might have been expected to be relatively poor.

For the poorest developing countries, private capital flows have not replaced foreign aid. Evidence on the determinants of capital flows does not give a sanguine view of the chances for these countries to gain access to international capital markets in the short to medium term. Furthermore, much of the investment required in low income countries is of the type conventionally eschewed by the private sector. Foreign aid will therefore remain important for low income countries.

The above analysis paints an increasingly positive picture. But what about the politics?

Aid Regeneration: the Politics

While the ending of the Cold War has removed the strategic military and political motives for giving foreign aid, this type of bi-lateral aid was, in any case, ineffective in economic, humanitarian, and probably even in political terms. Aid was frequently allocated to recipients simply because of their strategic significance. It was often associated with poor economic policies and therefore never had much chance of being successful. Recipients did not have to concern themselves with hard policy choices since they could in effect trade on their strategic importance.

The thawing of the Cold War creates an opportunity for donors to re-focus aid on countries where sound policies are being pursued, and where there is a reasonable presumption that it will show a high economic and social rate of return. To the extent that some developing countries have access to private capital markets to meet their financial needs, foreign aid can be concentrated on the rest, and in particular the low income countries.

Other political factors towards the end of the 1990s are also conducive to a regeneration of foreign aid. As the industrial economies have moved out of recession the sizes of their fiscal deficits have fallen and this reduces the domestic political opportunity cost of foreign aid from the donors' perspective. It is perhaps relevant that a regeneration of interest in aid, as reflected in 1997 by the publication of a new governmental White Paper, happened in the UK where macroeconomic performance was generally stronger than elsewhere in Europe. Furthermore, the new Labour Government elected in 1997 might be thought likely to give a higher priority to reducing income inequality both at a national and an international level. The election of a new government could also be reflective of a changing public mood. Given the media attention paid to global poverty in the run-up to the G7/G8 summit in England in 1998, there is also some additional evidence of an increasing degree of public support for policies directed towards reducing global poverty. Evidence that aid is effective in encouraging economic growth and reducing infant mortality can only help to strengthen an incipient increase in such support.

A recent analysis of public attitudes towards foreign aid across OECD countries is helpful in identifying trends, differences between donors, and factors which influence public support for aid. The study shows that except in a few donors, public support for aid did not generally decline during 1983-95. However, the exceptions included the United States and Canada, where the opposition to aid grew strongly in the mid-1990s. When assessed against other foreign policy objectives foreign aid is generally ranked towards the bottom. Out of the ten foreign policy goals only 16 per cent of Americans placed development assistance as their top priority, and overall aid was ranked ninth. Public attitudes in OECD countries favour aid to the needy as opposed to strategic allies, aid to countries that are geographically more proximate, aid channelled through multilateral institutions, and aid focused on health, basic needs, disaster relief and the environment.

While younger generations are more supportive of aid, there is a widespread scepticism about aid-effectiveness and in particular the effects of waste and corruption.

What determines public opinion concerning aid? It does not seem to depend on economic conditions in donors, even though high domestic unemployment is often cited as a reason for opposing aid. Moreover, it does not seem to depend on the donor's degree of openness; although liberal immigration policies are sometimes seen as a substitute for aid. Ethical and moral considerations, along with perceptions of the effectiveness of aid appear to exert an important influence over public opinion.

Survey data therefore suggests that public support for aid can be increased by evidence that it is more effective in raising economic growth and more particularly improving human development. Reforms that seek to strengthen aid's effectiveness are therefore likely to receive public support. Aid fatigue amongst the general public is not a widespread phenomenon across all donors and there is still a basis of public support upon which regeneration can take place.

Reforming Foreign Aid: The Role of Conditionality

The reform of foreign aid raises both relatively uncontentious and contentious issues. Relatively uncontentious is that the global political environment in the second half of the 1990s better allows foreign aid to be allocated to where it is most needed. This argues for a shift from bi-lateral aid, which has always been more political, to multi-lateral aid which can focus more strongly on recipient needs. It also argues for a further reduction of aid to countries that do not have access to private international capital markets.[10] By redirecting aid away from where it is ineffective to where it is effective, its overall effectiveness can be increased with no necessary increase in the total amount of aid.

Also fairly uncontentious is the claim that the quality of foreign aid for recipients may be increased by making it simultaneously both more micro and small scale, perhaps by being more heavily channelled through NGOs, and more macro, supporting programmes of macroeconomic policies. Aid should continue to shift away from focusing inappropriately on large scale capital projects. In relation to this, the quality of aid would be increased by reducing the extent to which it is tied to projects and procurement; this would allow aid recipients to develop in ways that most effectively exploit the availability of domestic resources.

It is also uncontentious that recipients will benefit more from foreign aid if they pursue sound economic policies. Furthermore, there is probably reasonable consensus about what these policies are? More contentious is how to ensure that aid recipients pursue such policies.

What does the evidence show about the connection between aid and domestic policy reform? Does aid facilitate poor policies or encourage good ones? The answer is rather inconclusive. Good and bad policies have historically been pursued with and without aid. Burnside and Dollar (1997a) conclude that

> 'there is no systematic relationship between the amount of aid that countries get and policy reform (or the lack of it) [...] policy reform is largely driven by domestic social and political forces' (p. 6).

On the other hand, Mosley and Hudson (1997) attribute the increased effectiveness of aid since the early 1980s in part to the conditionality of the World Bank. So what is the role of conditionality in raising the effectiveness of aid? Can it be used to persuade reluctant governments to adopt sound policies and thereby link aid to policy reform?

The emerging evidence on the political economy of policy reform is fairly clear that conditionality does not induce reform unless governments are fully committed to it (Bird, 1998, Killick 1998). Where 'ownership' is low, they tend to back-slide and fail to implement agreed programmes (Johnson and Wasty, 1993). Multilateral aid agencies and the IFIs should therefore focus on trying to maximise the commitment of aid recipients to reform.[11] In one way or another governments need to be empowered to design their own programmes for development and poverty alleviation and then be judged on their efforts to carry them through, allowing for factors beyond their control such as adverse terms of trade shocks.[12] On the twin bases of evaluating domestically designed *ex ante* programmes and *ex post* performance, donors should adjust their allocation of aid in order to establish an appropriate set of incentives. Developing countries pursuing poor policies should not generally receive large amounts of aid. Those pursuing good policies should be supported. As noted earlier, foreign aid raises the rate of return to good policies and it can in this way incentivise governments to adopt sound economic policies. Greater selectivity by donors in the allocation of aid will therefore create the appropriate incentive structure.

Conditionality is not an effective mechanism for inducing policy reform. Indeed Collier et al (1997) argue that there are fundamental inconsistencies between the inducement function of conditionality and its other functions such as selectivity and signalling. They propose that aid allocation should reflect *ex post* growth performance and human development rather than *ex ante* policy conditionality. Such a change taken to extreme would probably be politically unacceptable to donors. However, it may be feasible to re-focus conditionality on eliminating a narrower range of key distortions, thereby leaving as much policy discretion as possible in the hands of governments, that will then be judged on the basis of *ex post* economic performance, modified to allow for external factors beyond the control of the country concerned.[13]

The above analysis suggests that reform of foreign aid should focus first, on moving away from bi-lateral aid towards multi-lateral aid, and second, on reforming the conditionality of the multi-lateral aid agencies, in particular the World Bank, in a way that minimises conditionality and concentrates more narrowly on key areas of economic policy and performance.

Clearly there will be occasions when emergency relief has to provide an exception to the above rule, but if aid is to have positive effects on development and poverty reduction it has to be perceived as an *instrument* for achieving these objectives rather than the simple outcome of underdevelopment and poverty.

Concluding Remarks

Frustration with its apparently poor record in achieving its developmental and poverty-reducing objectives, combined with political changes in the world, brought about a sharp decline in foreign aid in the mid-1990s. This was the era of aid fatigue.

Some commentators saw declining aid as an entirely good thing - emphasising the ineffectiveness of aid - while others saw the situation as critical, condemning many millions of people to poverty.

On the basis of recent analysis and evidence the conclusion may be reached that, when combined with sound domestic economic policies, foreign aid has a discernibly positive impact on both economic growth and other indicators of human development. It may also be concluded that, as there has been an increasing global consensus upon what these policies are, so aid has in turn become more effective. The decline in foreign aid in the first half of the 1990s has therefore been a lagged response to its earlier poor record.

As there is a greater recognition of what aid can achieve, there is a reasonable presumption that foreign aid will be re-generated. This presumption is re-enforced by global political changes which initially led to declining aid flows but may subsequently lead to a re-direction of aid to countries where it is likely to be effective in economic and humanitarian terms. Such a re-direction of aid will create a set of incentives that encourages developing countries to pursue policies that will assist their future development.

This having been said, it would be unwise to expect too much from foreign aid. Research undertaken at the Harvard Institute for International Development, and briefly reported by Sachs (1997), shows that many of the poorest regions of the world suffer from geographical impediments that aid will find it difficult to overcome. In a way, however, this makes it even more important to ensure that foreign aid plays as positive a role as it can. With increasing evidence that aid can make a difference, and with a more conducive political environment, the era of aid fatigue in the mid 1990s may be followed by one of aid regeneration. Indeed with the publication of the UK Government's White Paper in 1997 and preliminary evidence to suggest an upturn in the flow of foreign aid in 1997 (see Table 1), there is reason to believe that regeneration may have already begun.

NOTES

[1] Table 2 shows that in percentage terms the decline in ODA was sharper in both Finland and Italy than in the US. But in absolute terms the reduction in US aid was more significant. It is also noteworthy that while 15 members of DAC increased their expenditure on technical co-operation between 1994 and 1995 in current prices, the US cut its TC budget.

[2] White (1992) provides a comprehensive review of the theory and evidence relating to all these factors showing, on balance, that fear about the potentially adverse consequences of aid are not without justification. On the issue of fungibility, for example, Heller (1975) discovered a tendency for aid to be used to reduce taxation, although Pack and Pack (1990, 1993) found that the extent to which aid was used to support fiscal deficits associated with current expenditure varied between countries. Feyzioglu

et al (1996) report evidence that from every US$1 of ODA, about 75 cents goes to governments' current expenditures. However, they also test aid fungibility across public spending categories finding that concessionary loans given to transport and communication are fully non-fungible, whereas, loans to the energy sector, agriculture and education are fungible. Empirical support for Dutch disease effects in Africa comes from van Wijnbergen (1986) and more recently Younger (1992) covering the case of Ghana. Although White (1992) is critical of the methodology used by van Wijnbergen, he also argues that the effect of aid on the real exchange rate may be significant for economies that are highly aid reliant, and cites other evidence of the effect in Sri Lanka (White and Wignaraja, 1991).

[3] Representative is a quote from Mosley (1987); 'there appears to be no statistically significant correlation in any post war period, either positive or negative, between inflows of development aid and the growth rate of GNP in developing countries when other causal influences on growth are taken into account,' p 139; although he goes on to warn against drawing too many quick conclusions from this in terms of the effectiveness of aid, since the impact of aid is too multi-faceted to be captured adequately by a single relationship. Mosley also analyses the micro-macro paradox, which is a theme discussed by Cassen et al (1994) and by White (1992). For further more recent evidence of the apparent macro ineffectiveness of aid see Boone (1994), and Brewster and Yeboah (1994). Snyder (1996) discovers a negative relationship between ODA and private investment across 36 developing economies which is particularly strong in the case of low income countries.

[4] Again Mosley (1987) finds little evidence to support the claim that aid benefits the poorest; a conclusion broadly consistent with the one reached by Riddell (1987). While Cassen (1994) points out that the poor may benefit from aid directed towards rural projects and raising agricultural output, it appears that aid is at its least effective in these areas (World Bank , 1989).

[5] Evidence presented by Killick (1991) suggests that aid has been at its least effective in Africa according to a range of criteria. He juxtaposes this with the fact that at the same time a higher proportion of aid has been directed towards Africa.

[6] There is even evidence that donors may design their aid policies in order to assist the foreign policy objectives of other countries in order to indirectly favour their own (Katada, 1997).

[7] The principal recipients of aid from France in 1994-95 were (in descending order) Côte d'Ivoire, Egypt, New Caledonia, French Polynesia, Cameroon, Senegal, Morocco, Congo, Algeria, Gabon, Vietnam, Madagascar, Niger, Indonesia and Burkina Faso. In the case of the UK the principal recipients included India, Zambia, Bangladesh, Uganda, Malawi, Pakistan, Zimbabwe, Kenya, Ethiopia, Rwanda, Mozambique and Tanzania.

[8] Burnside and Dollar also discover that in a sound policy environment aid attracts private investment whereas in a poor policy environment it displaces it.

[9] It is interesting to note that the micro-macro paradox has to some extent been reduced by the fact that the micro effectiveness of aid seems to have fallen over recent years. The Bank's Portfolio Management Task Force: Key to Development Impact, Washington, World Bank, September 1992, reported that 37.5 per cent of projects in 1991 had an economic return of less than 10 per cent. The success of World Bank projects fell from 87 per cent over 1979-81 to 65.7 per cent in 1989-91. The Bank's own analysis was that the decline in performance was associated with the 'pressure to lend', which tended to create a preference for large scale projects.

[10] However, the danger that aid will become conceptualised as a long term substitute for private capital flows, with the associated moral hazard and aid-dependency problems, needs to be countered by visibly pursuing a policy by which there is greater willingness to redistribute aid, favouring those developing countries that demonstrate a commitment to and progress with economic reform. In the long run aid recipients should be envisaged as graduating to a status where their creditworthiness is increased and they gain access to private capital. There are various ways in which multi-lateral aid could be directed towards low income countries (for examples, see Bird, 1983, 1994).

[11] The view that 'the key role of multilateral agencies in foreign aid is their provision of conditionality' (Rodrik, 1996) has to be treated with caution.

[12] Various ideas have been canvassed including that of a 'development contract', which would involve reciprocal obligations between donors and recipients. Donors would commit themselves to a certain level of assistance, while recipients would commit themselves to certain policies. Aid, alongside debt relief and trade would therefore form part of the contract (Ofstad et al, 1991; Jayawardene, 1993; Stokke, 1996; and on a similar theme, Hyden, 1995). The problem would probably be in determining what happens when contracts are broken.

[13] This conclusion is not inconsistent with Mosley and Hudson's finding that aid has become more effective over a period of time when conditionality has been increasing. Aid recipients may have become more aware of and committed to economic reform independently of World Bank conditionality. As Mosley and Hudson (1997) point out it may be the policy dialogue that negotiations with the World Bank have involved rather than the World Bank conditionality itself which has improved the quality of economic policy. Given the criticisms of conditionality as a modality for fostering economic reform, redesigning it could improve the quality of implemented policy still further. This conclusion is also consistent with Burnside and Dollar's observation that policy reform 'is largely driven by domestic social and political forces' (1997a, p6).

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