ESSAYS IN INTERNATIONAL FINANCE

No. 69, July 1968

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ALBERT O. HIRSCHMAN AND RICHARD M. BIRD

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DEPARTMENT OF ECONOMICS

PRINCETON UNIVERSITY

Princeton, New Jersey

This is the sixty-ninth number in the series ESSAYS IN INTERNATIONAL FINANCE, *published from time to time by the International Finance Section of the Department of Economics at Princeton . . .*

Albert O. Hirschman is Lucius N. Littauer Professor of Political Economy at Harvard University. From 1958 to 1964 he was Professor of International Economic Relations at Columbia University. His books include The Strategy of Economic Development, Journeys Toward Progress, *and* Development Projects Observed *(1967). He is the author of numerous articles in professional journals.*

Richard M. Bird was Lecturer on Economics at Harvard University when this essay was written. He is at present Associate Professor of Economics and a member of the Institute for Policy Analysis at the University of Toronto. He is co-author of Financing Urban Development in Mexico City *(1967) and co-editor of* Readings on Taxation in Developing Countries *(1967), as well as author of a number of articles, mostly on public finance, in professional journals.*

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FRITZ MACHLUP, *Director*
International Finance Section

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L.C. Card 68-55575

Printed in the United States of America by Princeton University Press
at Princeton, New Jersey

FOREIGN AID–A CRITIQUE AND A PROPOSAL

Foreign aid is as Janus-faced an institution as can be found. In a world of sovereign nations, rich and poor, it is an instrument of national policy which can be used by the rich to acquire influence and to increase their power. At the same time, foreign aid redistributes income from the rich to the poor and can thus serve to speed the latter's development.

While foreign aid might never have come into this world without its appeal to both national and trans-national interests, it has also suffered from the resulting ambiguity about its "real" function. Unlike pure power instruments like national military establishments, on the one hand, or overt redistribution mechanisms like the progressive income tax, on the other, foreign aid has never been firmly institutionalized. It has led a precarious existence, bolstered from time to time by cold-war conflicts and then flagging again as immediate dangers passed, or the lack of a "domestic constituency" in the aid-giving countries made itself more strongly felt, or certain unpleasant side-effects of aid-giving became apparent. Lately signals of a new crisis in aid-giving have multiplied in the United States; there is disaffection and disenchantment as well in Western Europe and perhaps in the Soviet Union, and foreign aid is none too popular even in the recipient countries.

The first part of this essay attempts a partial explanation of this state of affairs through a critique of basic concepts underlying present aid programs of the United States as well as some multilateral ones. The second part of the paper discusses an alternative mechanism of transferring aid, which would avoid some of the more conspicuous difficulties that have been encountered. The two parts of the paper are not tightly integrated, however: it is quite possible for a reader to agree with our critique while disagreeing with the proposal, and vice versa.

A CRITIQUE OF PROGRAM AID

Current practice in foreign aid dates from the new principles introduced by the Kennedy Administration in the early sixties. Essentially, this country's doctrine moved at that time to embrace what has since become known as the "program approach" to foreign aid.

From project to program aid

The "project approach" had predominated through the fifties. The

World Bank had been enjoined by its very statutes to extend loans only on the basis of specific projects (in transportation, power, agriculture, and so forth). The first activity of the United States in the field of aid to underdeveloped countries was technical (Point Four) assistance, which had necessarily a project content and which evolved naturally into capital assistance with a similar content. Important departures from this practice occurred in countries on the periphery of the Soviet bloc. To a number of these countries the United States extended massive military as well as economic assistance, with the latter being usually justified in terms of short-term import or budgetary requirements.

By 1960 criticism of the project approach was widespread. It was easy to show how development depended not on a few specific projects, but on an adequate overall investment effort, with respect to both aggregate size and composition, and how ill-designed fiscal, monetary, and foreign-exchange policies could undercut the positive contribution of any individual project to economic growth. Economists further pointed out that the donor country was not really financing the project for which it was ostensibly granting funds, but rather the "marginal" project which the aid recipient would have just given up had he not been handed the additional resources for a project which he probably would have undertaken in any event.[1] For these reasons, so it was argued, a look at the total spending pattern of the recipient country is essential if one wishes to have some assurance that the aid funds are put to productive use. Finally, it was pointed out that project aid necessarily implies a series of biases and perverse incentives: it encourages the aid recipient to prepare large capital projects, to exaggerate the foreign-exchange portion of the total cost of these projects, and to favor public infrastructure projects, which are most easily financed through loans or grants extended from one government to another for project purposes.

While these criticisms of the project approach all contributed to a change in the climate of expert opinion, another important reason for going from project to program aid was the desire to increase the level of aid to some key countries and to provide a solid institutional basis for aid-giving at this higher level. Program aid was conceived as aid given "in bulk" on the basis of a general understanding between donor and recipient about the latter's development program and principal economic policies. (Other terms frequently used in connection with program aid are, in ascending order of euphemization, "leverage," "incentive programming," "making sure of self-help.")

As a result of what was then thought to be the model case of India,

[1] For a critique of this view, see Richard M. Bird, "The Influence of Foreign Aid on Local Expenditures," *Social and Economic Studies*, Vol. XVI (June 1967), pp. 206-210.

the accent was at first primarily on achieving agreement on the recipient's development plan, its size, priorities, and the resulting "resources gap" to be filled by aid in its various forms. But, in most developing countries development plans are primarily statements of intention. Further, even in the rare country with a highly operational development plan, the fulfillment of the plan's objectives would depend crucially, among other things, on "appropriate" fiscal, monetary, and other economic policies. In Latin America, moreover, program aid under the Alliance for Progress was to be forthcoming not only in connection with a broad agreement on economic-development objectives, but was to be premised also on advances in social development that depended on the enactment and implementation of reforms in land tenure, income taxation, educational opportunity, and the like.

The two aid bargains compared

The general idea of moving from the project to the program approach consisted, therefore, in laying the groundwork for a substantial and steady flow of aid through a meeting of minds between donor and recipient on central economic programs and policies of the recipient country.

When the matter is put in this way, the formidable difficulties of the program approach begin to appear. No doubt, by moving the discussion between donor and recipient from where to build what kind of power station to fiscal, monetary, or agrarian reform policies, one is turning from peripheral to central issues of the recipient's decisions. But is that a good thing? We shall now argue that this move raises at least as many problems as it solves.

To facilitate the discussion, it is useful to attempt at this point a conceptual distinction between "pure" project and "pure" program aid. In the real world this distinction will of course be blurred, as these two archetypes of aid hardly ever appear in their pure forms. Hence it should be understood that our subsequent discussion does not cover every conceivable case of project or program aid, but tries to catch the essential difference between two diverse forms of aid-giving. Moreover, we do not aim at extolling project aid, with whose problems and drawbacks we are familiar, but rather at bringing out, with project aid as a backdrop, the heretofore largely neglected political implications and side-effects of program aid.

As a starting point for the discussion, we may imagine that aid is given in the form of a check drawn by the donor to the order of the recipient, without conditions or strings of any kind. This unconditional aid can then turn into conditional aid along two principal routes.

First, the donor can insist that the money be spent for certain specific purposes: the result is pure project aid as here defined. Secondly, the donor may require that the recipient country change some of its ways and policies as a condition for receiving the funds: this is our definition of pure program aid.

From the point of view of the recipient, there is a fundamental difference between the two bargains which may conceivably accompany the transfer of aid funds. Pure project aid forces the recipient country to substitute to some extent the donor's investment preferences for its own insofar as the use of the aid funds is concerned. As a result, the recipient country lands in a situation it senses as inferior to the one in which the same amount of aid would be available unconditionally. Nevertheless, the aid permits the country to achieve a position in which it is unequivocally better off than without aid, in the sense that more funds are forthcoming for some purposes while, generally speaking, investments that the country would have made in the absence of aid will not be curtailed. Thus, the conditions attached to pure project aid are not likely to arouse strong hostility in the recipient country and do not require the policy-makers to sacrifice any important objective which they would have been able to pursue in the absence of aid.

The situation changes significantly in the case of the bargain characteristic of pure program aid. The commitment a country undertakes in connection with this type of aid is typically of the following kind: to increase investment and decrease consumption, to increase the share of the private sector and decrease that of the public sector, to devalue the currency and thereby alter *relative* price relationships within the country, to throttle inflation and therefore strike a blow at the particular interest group whose turn it is to benefit from the next inflationary appropriation, credit expansion, or rise in prices or wages; and so on, and so forth. In all these instances, compliance with the conditions attending program aid makes one group within the recipient country worse and another better off than before. The bargain preceding the granting of program aid also implies that the aid-receiving government will alter its previous policy-mix in such as way as to sacrifice in some measure objective A (say, a larger public sector) to objective B (say, growth).

Economists who have discussed the concept of community welfare have long been divided into two groups: those who deny, and those who affirm, that meaningful statements can be made about increases or decreases in collective welfare when, as a result of economic change, one group gains at the expense of another. There is no need for us to enter into this discussion, except to note that its protracted and stubborn nature testifies to the fundamental difference between the two situations that we have just described. With pure project aid, the recipient government can achieve all of its pre-aid objectives (plus some additional aid-financed ones) and no group in the country need be any worse off. With the type of conditional program aid discussed here, the objectives of public policies will be reshuffled and some domestic group is likely to be hurt. Even though the total resources available to the country are increased through the aid, the hurt group cannot be directly compensated, at least in the short run, for its loss, by the very terms of the aid agreement.

We should mention here one particularly important way in which project aid shades off in the real world into program aid. When the project donor spends its funds on, say, a certain kind of power station, it will often have views, and will attempt to have them prevail, on such matters as accounting practices, power rates, administrative autonomy, and perhaps even public versus private ownership of the utility. Project aid may then also involve policy changes that would hurt some groups or individuals. Even in this case, however, an important difference between project and program aid remains. Program aid is usually given in connection with changes in *central* economic policies of the recipient, whereas the policy changes the donor is liable to insist on in connection with project aid are germane to the construction and operation of the project and are therefore likely to be concerned with matters that are at some remove from the central policy concerns around which the more important group conflicts rage.

The program-aid bargain further considered

It will, of course, be argued that whatever sacrifice is entailed by the policy changes required by the program-aid bargain is more than fully compensated by the other side, namely the aid package itself. The fact that aid is accepted on these terms could be considered as evidence that there is nothing to worry about. After all, the recipient government could have refused aid (as Burma did in general, and Brazil and Colombia at one time or another, in connection with assistance from the International Monetary Fund) if it felt that the conditions were too harsh. But this application of the notion of revealed preference misses several points. In the first place, we were intent on showing the difference between two forms of conditional aid-giving and on pointing out that the cost of obtaining aid is of a different nature in the two cases. Secondly, it is a gross over-simplification to treat a government entering the program-type bargain on foreign aid like a consumer buying himself a bag of apples. Since aid, in this case, has as its counterpart a shift in national objectives and in the short-term fortunes of different social groups, the bargain will be considered a bad one by the circles that value highly the objective that has been sacrificed and by those groups whose interests have been hurt. Hence, the very bargain that gives rise to program aid can and will be attacked directly by these circles and groups as being damaging to the national interest as they define it. Pure project aid is ordinarily immune to this kind of destabilizing side-effect. Precisely for that reason, those who attack it will often resort to alleging that it is *impure* and carries some unavowed and excessive cost in terms of general economic or political-policy commitments. In other words, to be effective, an attack on project aid will attempt to prove that it is *really* program-type aid.

The difference between a country or a country's government adopting certain changes in its central economic policies as a *quid pro quo* for aid and a consumer disbursing cash for a pound of apples goes deeper still. The program-aid bargain is effective only if the government is genuinely convinced of the positive value of the policies it has adopted in conjunction with the aid—if there has been, that is, a genuine meeting of minds between donor and recipient about the economic-policy measures conducive to development. It is as if the consumer were not only made to hand over the cash, but were asked to positively enjoy this act instead of sensing it as a cost. Moreover, the commitment of the recipient government is ordinarily not just to a single policy action, but to a *policy* that requires implementation through a practically infinite *series* of actions. A more correct comparison of the program-aid bargain would therefore be to the decision of a person who joins the monastic orders: he does not usually consider his vows of poverty and chastity as a payment for the promise of eternal after-life, but as something to be valued and perhaps enjoyed directly and independently of that promise.

One matter is already becoming clear: for the commitments entered into in the course of program-aid negotiations to be faithfully adhered to, the recipient government ought to be so convinced of the correctness of the policies to which it commits itself that it would have followed these policies even without aid. Paradoxically, therefore, program aid is fully effective only when it does not achieve anything—when, that is, no *quid pro quo* (in the sense of a policy that would not have been undertaken in the absence of aid) is exacted as the price of aid. (It is ironical that, at least when it is effective, program aid is vulnerable to the very charge that has long been levelled—wrongly, we think—against project aid: namely, that one can never be sure that the project thus financed would not have been undertaken even in the absence of aid.)

In these situations, the donor would set himself the task of *rewarding* virtue (or rather, what he considers as such) where virtue appears of its own accord.

This is indeed a modest and manageable task, but it is also one that does not usually satisfy the donors. Precisely because the institutional basis and public-opinion support of aid are so precarious in the donor country, the proponents and dispensers of aid have quite naturally felt compelled to make extraordinary claims for what aid can accomplish. The most persistent of these claims has been that aid acts as a "catalyst." This term is meant to convey that aid makes the difference between stagnation (or perhaps deterioration) and vigorous economic growth of the recipient country, or between the recipient being hostile and being friendly to the donor country. To these traditional and exaggerated claims for aid, a new variant has been added by the program approach: namely, that aid, properly conditioned, makes the difference between the recipient following the "wrong" and adopting the "right" economic policies.

In this fashion, then, aid is not seen in the role of rewarding virtue, but in the role, infinitely more difficult, of bringing virtue into the world. Now the fact that aid is known to be available *if* certain policies are followed will sometimes serve to strengthen a domestic group genuinely and independently convinced of the correctness of these policies and it is therefore not inconceivable that aid will on occasion help this group to come to power. This is the ideal case in which program aid acts first as a catalyst and then achieves so complete a meeting of minds and so full a sharing of values and objectives between donor and recipient that from then on they will march hand in hand toward a better future.

We have on purpose drawn a caricature, for it is our conviction that this picture of program aid as a catalyst for virtuous policies belongs to the realm of rhapsodic phantasy. At best, situations in which aid helps virtue to triumph in this fashion are the exception rather than the rule. The normal case is far more prosaic: the knowledge that aid is available if certain policies are adopted serves to make these policies more attractive and less costly than they would otherwise be. These policies will therefore often be adopted by aid-hungry governments in spite of continuing doubts of the policy-makers themselves, resistance from some quarters within the government, onslaught against the "deal" from the opposition, and general distaste for the whole procedure.

Naturally, doubts and reservations are not voiced at the moment of the aid compact; hence the delusion on the part of the donor that there has been a full meeting of minds. But soon after virtue has been "bought" through aid under these conditions, the reservations and resistances will find some expression—for example, through half-hearted implementation or sabotage of the agreed-to policies—and relations between donor and recipient will promptly deteriorate as a result.

Problems encountered in buying virtue through aid

It may be argued that once a government has unequivocally committed itself to certain acts as a condition of receiving aid, there is a good chance that it will convince itself that these acts are truly in the national interest, even though previously it may not have thought so. Psychologists have developed the theory of "cognitive dissonance" to analyze individual behavior in similar situations. The theory teaches that if a person engages in "discrepant behavior"—in acts, that is, which cannot be reconciled with what he considers to be his beliefs and values—he will attempt to reduce the resulting dissonance by changing his values in such a way that harmony is restored.

However, the theory also stresses another point that is crucial here: if the discrepant behavior *is induced by either carrot or stick*, there will be far less consequential value change than if the discrepant behavior occurs in some accidental, absent-minded, or experimental fashion. If the behavior is rewarded (as it is, in our case, by the granting of aid), dissonance hardly arises, because, in accounting for his behavior to himself, the actor has a ready explanation and excuse for the fact that he did something contrary to his principles, opinions, or preferences. (For the same reason, declarations of support for a cause against which one has previously fought are unlikely to change a subject's prior beliefs when such declarations are exacted under torture.) Therefore, the very act of rewarding policy changes through aid undermines the determination with which these changes will be carried out and makes backsliding and sabotage more likely.

These considerations explain why certain types of policy commitments on the part of aid-receiving countries are more workable—and therefore have turned out to be more popular with the donors than others. The more workable and more popular commitments are precisely those that are highly visible, verifiable, measurable and, at their best, irreversible. One thinks of a revision of the customs tariff, of the imposition of credit restrictions in order to curb inflation, or, most typically perhaps, of a devaluation. In the latter case, there would seem to be little possibility of backsliding or of second thoughts. Yet, while devaluation cannot be retracted, its intended effects can usually be frustrated by subsequent monetary, fiscal, and wage-price policies. Hence, even in the case of devaluation, a government which harbors a feeling that it has been pushed into an unwise policy can often administer an "I-told-you-so" lesson to the donor just by omitting to carry out certain complementary policies after the devaluation.

In the case of other economic or social policies that sometimes have stood in the center of aid negotiations, the continued psychological resistance of the aid-recipients to such policies after a formal compact has been sealed can manifest itself more directly and easily. Whether the aid negotiations were concerned with enlarging the private sector of the economy or with establishing the basis for a land reform, the commitments a government has undertaken in these areas can be rendered inoperative through bureaucratic harassment or through lack of administrative energy, respectively. The old Spanish-colonial adage "*se acata pero no se cumple*" (one obeys but one does not comply) will thus be widely practiced once again, and properly so. A country which permits its key economic policies to be determined by this type of international negotiation finds itself in fact in a semi-colonial situation and is likely to adopt all the time-honored methods of stealthy and indirect resistance appropriate to that situation.

The fact that certain commitments have less latitude in implementation and are therefore less prone to sabotage than others has naturally led to a preference of aid negotiators for these types of commitments. In this way we can explain the increasing tendency to make program aid depend on the taking of specific monetary and exchange-rate measures and on the "appropriate" behavior of certain fiscal and monetary indicators, while less and less attention is paid to economic growth and social justice, supposedly the principal objectives of aid.

The hidden costs of program aid

The resistance of the recipient country to some of the policy commitments it has underwritten in the course of the aid negotiations is not the whole story. The general unhappiness about having had its arm twisted can find other outlets than backsliding on these same commitments.

In a simple model of international relations we may assume that, for the sake of independence, self-respect, and defense against accusations of being a satellite, the government of B, a poor country, is determined to maintain a certain *average distance* from country A, a great power and a potential donor. Country B measures this distance along two dimensions, the extent to which it adopts economic policies suggested by A and the extent to which it takes A's position in the leading issues of international politics. Under these conditions, a success on the part of the great power in having B "do the right thing" in economic policy will result in a strong urge on the part of B to compensate for this move in the direction of A by a move in the opposite direction in international politics. Only in this fashion can the desired average distance be maintained. That this model of international behavior is not completely unrealistic, in spite of its simplicity, can be shown by recalling a few episodes of the recent past: the attempt of the Quadros government in Brazil to move in the direc-