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**Bilateral Development
Assistance
Background and Options**

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BILATERAL DEVELOPMENT ASSISTANCE:
BACKGROUND AND OPTIONS

The Congress of the United States
Congressional Budget Office

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PREFACE

As the Congress prepares the First Concurrent Resolution on the Budget for Fiscal Year 1978, some of the most important issues in the international affairs function will concern the foreign assistance programs. This paper lays out some background for decisions on the size of the program and puts the U.S. program both in historical perspective and in the context of assistance programs provided by other donor countries. It also examines what is known about the impact of economic growth and foreign assistance on the lives of the poorest people in developing **countries--who** are the focus of the "New Directions" foreign assistance policy.

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Alice M. Rivlin
Director

February 1977

SUMMARY

Since U.S. economic assistance first became a foreign policy tool thirty years ago, **U.S.** aid has acquired increasingly diverse objectives and recipients. The current mixed collection of programs and objectives is derived from the various military, diplomatic, commercial, humanitarian, and developmental directions U.S. aid has taken in the past.

The most focused assistance policy was the first: the reconstruction of Western Europe and Japan following World War II. When the targets of assistance shifted to developing states, the objectives and uses of foreign assistance gradually became more diverse.

Meanwhile, the levels of real assistance spending gradually declined. In constant dollars, annual U.S. economic assistance has declined to approximately one-third of what was allocated during the Marshall Plan. At the same time, other donors' assistance has slowly increased. U.S. assistance now represents slightly less than 25 percent of the total economic assistance given to developing states. Most of the remaining 75 percent comes from other Western countries which also give assistance toward a variety of sometimes inconsistent political, commercial, and humanitarian objectives.

In fiscal year 1977, U.S. economic assistance programs will total slightly more than \$5 billion. The four major programs the United States maintains include: security supporting assistance (32 percent of the **total**), bilateral development assistance (**20** percent), multilateral development assistance (18 percent), and Public Law 480 food aid (21 percent). Several different agencies administer these programs, and they pursue diverse and occasionally conflicting objectives. These objectives represent a mixture of short-term political and security goals and long-term developmental objectives. U.S. **programs--their** size, structure, and **distribution--differ** from other donors' primarily in degree. The United States has more different kinds of assistance programs and distributes its funds more broadly than most other donors.

The multiple objectives of U.S. assistance make any evaluation of **effectiveness** difficult; no single standard is available for judging its overall success or failure. The assistance objectives that are the most detailed, the most often discussed, and the most frequently revised are those of economic development. The United States supports similar development efforts through contributions to international financial institutions and through the bilateral program of the Agency for International Development (AID).

The Congress has, of course, more direct authority over the bilateral program and recently used that authority to revise its objectives. A Congressional mandate of 1973 directed that priority be given to the problems of the poorest peoples within developing countries. This policy, known as New Directions, represented a major shift from previous efforts to promote economic growth through large industrial and **infrastructure** (e.g., irrigation or transportation) projects. The New Directions mandate explicitly applies to the 45 percent of U.S. foreign assistance extended through the bilateral development program and Public Law 480 food aid.

The New Directions legislation has resulted in a change in the types of projects sponsored by AID. Since 1973, AID has placed greater emphasis on small-scale agricultural development, and health and education projects designed to benefit the poorest people in developing countries. Large-scale, capital-intensive projects considered less likely to benefit the poor directly have been all but discontinued.

The **effectiveness** of present **AID activities--particularly** in terms of the contribution to increasing the welfare, **productivity**, and income of the very **poor--is** difficult to measure. In relation to the developing countries' problems of poverty, **unemployment**, malnutrition, and ill health, the U.S. aid effort is quite small. In most recipient countries U.S. bilateral development assistance amounts to considerably less than one percent of GNP. Because of this, U.S. aid by itself is unlikely to bring about major changes in the welfare and income of the poorest peoples in developing countries.

Permanent improvements in the lives of the majority of the poor are essentially dependent upon the economic and social policies of the governments of developing coun-

tries themselves. The experience of a few countries, such as Taiwan and South Korea, has indicated that, with the right combination of government policies, economic growth accompanied by a redistribution of income is possible. The **effectiveness** of U.S. development aid would seem to depend less on its direct and immediate effects than on the extent to which it contributes to the adoption of appropriate policies by recipient countries. Little evidence is available, however, for assessing how effective assistance has been in favorably modifying development policies. Similarly, there are no clear indications whether increased or decreased amounts of assistance would **significantly** raise or lower U.S. influence over recipients' development policies.

AID is pursuing some, but not all, of the assistance policies consistent with long-term promotion of both economic growth and an equitable distribution of income in the economies of Less Developed Countries (LDCs). AID currently trains LDC personnel in the planning and management of development programs; eases foreign exchange and other resource shortages which constrain the policy options available to LDC governments; and conditions grants or loans to recipient governments upon specific policy changes. Other activities not currently included in the programs, which might also promote long-term, equitable LDC growth, are increasing employment opportunities in LDCs by supporting small-scale industry, and encouraging the manufacture and export of labor-intensive goods. These activities could be added to the bilateral aid program either by reducing some of the present activities or by appropriating additional funds. 1/

For fiscal year 1978, the Congress may wish to consider adjusting the level of bilateral development funding relative to the appropriations for multilateral development assistance. In recent years, **AID's** development efforts and the international financial and developmental organizations have been supported at approximately the same level. For fiscal year 1978, however, a combination of arrearages in

1/ An estimated \$1.2 billion in budget authority (5 percent above fiscal year 1977) would be required in fiscal year 1978 to maintain the fiscal year 1977 real level of bilateral assistance.

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past contributions and new subscription agreements have raised the request for multilateral development assistance by 90 percent. If these increased multilateral contributions are approved, funding bilateral development assistance at the current policy level would result in a shift to a predominantly multilateral development assistance program. 2/ Maintaining the current balance between multilateral and bilateral aid could require an increase of 60 percent or more in the bilateral development program. Unless security supporting assistance or food assistance is cut, this would also mean a substantial growth in the total economic assistance function. If Congress wishes to support the growth of the international financial institutions as an alternative to bilateral development assistance, a 50 percent cut in bilateral assistance would be required to fully offset the prospective increase in contributions to international financial **institutions.**

2/ A forthcoming companion CBO study on international financial institutions examines the options for adjusting levels of multilateral funding.

The Congress, in its review of the fiscal year 1978 budget, will face decisions about the spending levels to approve for foreign economic assistance as well as the allocation of funds for the various aid programs. As background for these decisions, this study provides a profile of the current U.S. assistance effort, its historical evolution, and its international context. The current diversity and wide distribution of U.S. aid, as exemplified in the mix of four major assistance programs, can best be understood against the background of the thirty-year history of gradually adding both objectives and recipients. The assortment of programs and activities for which this year's budget will request support is very much the product of that history.

During the past ten years, while aid from other users has increased, U.S. assistance has, in constant dollars, steadily declined; it now amounts to only 25 percent of the total flow of aid to developing countries. Because U.S. economic assistance is unevenly distributed, most recipients depend on the United States for less than 15 percent of their total foreign aid. In view of this, the international context of U.S. **aid--where** it goes and what it does as compared with aid from other **donors--would** seem increasingly important to Congressional decisions about the allocation and uses of foreign assistance.

This study also examines the **multiple--and** sometimes **conflicting--objectives** of U.S. assistance. The feasibility and **implementation** of recently revised goals for bilateral development assistance are given particular attention. Along with the programs of many other Western donors, U.S. bilateral development assistance efforts have recently been revised. Development objectives no longer emphasize industrialization and increased GNP alone. Instead, the objective is now development that will benefit the poorest groups within Less Developed Countries (LDCs): those people who apparently did not share in earlier economic expansion. This study examines the prospects that such development can be achieved and that U.S. assistance can contribute to both economic growth and equitable income distribution.

The Agency for International Development (AID) response to the revised objectives is assessed, and additional projects that might better promote equitable development are considered. A final section considers the relative funding balance between the bilateral and multilateral development **programs.**

The United States' economic assistance efforts are the product of thirty years of gradual change in the purposes and uses of aid. The current mix of programs and recipients is derived from the various military, diplomatic, humanitarian, and developmental directions U.S. aid has taken in the past. Today's emphasis on assistance to the poorest groups within developing countries is only the most recent of a succession of assistance objectives. The current mixture of long-term development objectives with immediate political and security goals is the result of a history during which aid objectives have gradually been added but only occasionally discarded.

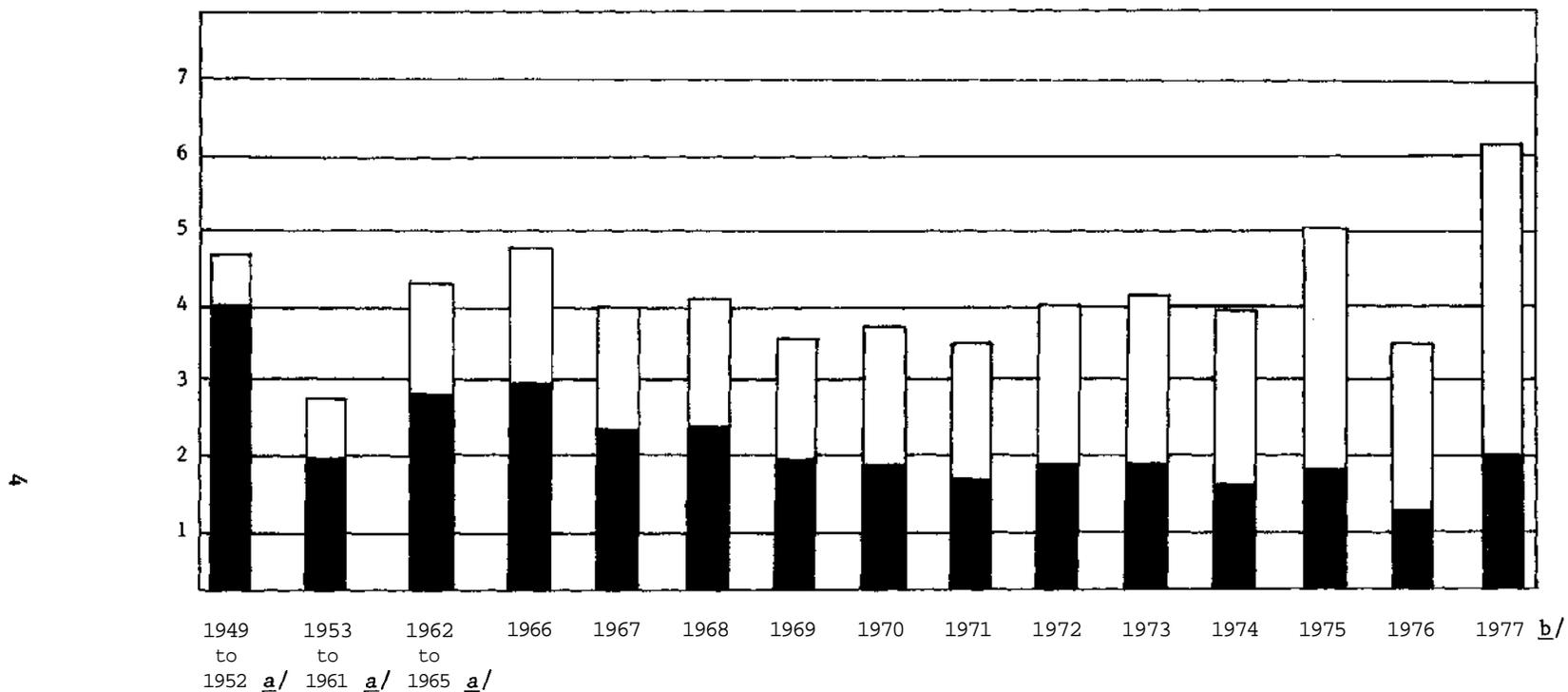
The most specific U.S. aid policy was the first: the reconstruction of Western Europe and Japan following World War II. During the Marshall Plan (1948-1952), the United States also maintained its highest level of economic assistance as measured in constant dollars (see Figure 1).

In the 1950s, as the perception of the Communist threat increased, and as Europe recovered from the war, U.S. economic aid was redirected from Europe and Japan to the developing world. When the Korean War ended in a stalemate and the United States faced the prospect of a continuing military commitment in Asia, U.S. aid backed security policies towards South Vietnam, South Korea, and Taiwan. During most of the 1950s, Asia was the recipient of two-thirds of all U.S. economic assistance, most of it closely aligned to U.S. military objectives. The remaining recipients were primarily less-developed European and Middle Eastern states along the periphery of the Soviet Union.

By the end of the decade, the area and purposes of U.S. aid had broadened considerably. Decolonization in Africa and anti-Americanism in Latin America created new candidates for aid. Not only **Communist** expansion, seen as a worldwide threat, but also general political discontent and economic instability were accepted as problems to be treated with foreign assistance. Greater emphasis began to be given to the use of aid for economic development purposes. U.S. aid funding in constant dollars continued to decline, but recipients were added in Latin America, Africa, and the Near East.

FIGURE 1. U.S. ECONOMIC ASSISTANCE: FISCAL YEARS 1949-1977 (TOTAL OBLIGATIONS AND LOAN AUTHORIZATIONS)

Billions of dollars



Current Dollars 1

Constant Dollars

Source: For fiscal year 1949-1975 current dollars, see U.S. Overseas Loans and Grants 1945-1975 (AID publication). Constant dollars derived from U.S. GNP deflator.

a/ Average for span

b/ CBO estimate

In the late 1950s and early 1960s, the United States also began to urge its allies to provide a greater share of aid for the developing world. Western European states had recovered sufficiently from the war to afford enlarged aid programs, but most gave only relatively small amounts of aid to former colonies. The first efforts to coordinate Western aid took place in NATO. As the emphasis of assistance doctrines shifted from anti-communism to development, Western states moved their aid consultations from a military to an economic organization. The Development Assistance **Group--soon** to become the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (**OECD**)--**was** founded in 1960 within the Organization for European Economic Cooperation (OEEC). The U.S. efforts to use the DAC to promote burden-sharing were not immediately successful. In the early 1960s, U.S. aid transfers increased more rapidly than those of any other donor: this was to be the only significant increase in U.S. aid funding since its beginning.

In the early 1960s, the United States substantially increased its own contributions to a number of existing international development organizations and financial **institutions**, such as the United Nations Development Program (UNDP), the World Bank, the International Development Association (**IDA**), and the Inter-American Development Bank (**IDB**). Contributions to multilateral **institutions**, however, remained at about 5 percent, a relatively small portion of total U.S. economic aid. 1/

In the early 1960s Washington not only increased aid funding, but also enlarged the number of aid recipients. United **States--and Soviet--economic** assistance began to go both to established allies and to "non-aligned" countries. With non-aligned states receiving aid from both superpowers, the relationship between donor and recipient became more complex. The non-aligned states resented explicit political conditions for aid and the U.S. began to offer its aid in less political and more developmental terms. In 1961, the Agency for International Development was established to coordinate U.S. economic assistance efforts and to underscore the new importance of developmental economic goals.

1/ The references to U.S. multilateral development contributions include all funds authorized and appropriated in a given year.

When in the mid-1960s the open Soviet-American rivalry subsided, so did their competition for Third World supporters and their aid to non-aligned states. The post-1966 decline of U.S. aid was hastened by domestic disillusionment with the **effectiveness** of assistance. Except for a handful of countries that had made visible progress toward economic development, the problems of poverty and economic stagnation in the LDCs appeared to be unaffected by U.S. aid. In 1965, the outbreak of hostilities between India and **Pakistan--** two major recipients of U.S. **aid--seemed** further to confirm disillusionment with assistance. Set against domestic tensions and **balance-of-payment** problems, aid funding steadily declined.

With the growing U.S. involvement in Vietnam in the mid-to-late 1960s, the use of economic aid for political and security purposes again became prevalent. In the early 1970s, as the overall level of U.S. assistance continued to decline in constant dollars, an increasing portion of that assistance was directed toward Southeast Asia. This meant further reductions in development aid to recipients in other **regions.**

During the Vietnam War, Public Law 480 food aid also came to be used more for security purposes than in the past. The Public Law 480 program was initiated in 1954 primarily as a method for disposing of surplus U.S. agricultural commodities abroad. The humanitarian and developmental objectives were given a greater emphasis, however, with the adoption of the Food for Peace legislation of 1966. **Nevertheless,** during the late 1960s and early 1970s, Public Law 480 loans and grants went in increasing amounts to the countries of Southeast Asia, where they were used to generate domestic funds for military or security purposes. Under legislation passed in 1974, the practice of using local currency repayments of Public Law 480 loans for these purposes was restricted; recipient countries were required to use Public Law 480 food aid primarily for developmental purposes. 2/

As overall U.S. economic assistance continued to decline in constant dollars between 1965 and 1975, aid flows from other donor countries increased **significantly.**

2/ Public Law 94-161.

The "burden-sharing" which the United States had urged in the 1950s came to pass in the late 1960s and early 1970s. U.S. assistance dropped from 60 percent of total economic aid provided by all donor countries in 1965 to less than 25 percent in 1975. 3/ This increase in **other** donors' efforts seems, however, to be less a matter of their responding to **U.S.** encouragement of burden-sharing, than of their finding their own **reasons--political**, commercial, and **humanitarian--for** enlarging their aid programs.

The most significant growth in economic assistance **came** from France, West Germany, and Japan, each of which more than tripled its official development assistance **between** 1965 and 1975. Smaller **donors--particularly** Canada, Sweden, the Netherlands, and **Denmark--also** increased their economic assistance **substantially**; they became the innovators of developmental themes. Through the DAC, targets for "common aid efforts" became subjects for international coordination. The DAC was by now an active donors' club attempting to increase the volume and to mold the uses, directions, and rhetoric of development aid. The United States found itself becoming the target rather than the initiator of DAC proddings to increase assistance efforts.

Many of the other DAC members found development assistance to be an attractive means of building closer economic and political ties with LDCs. They also found aid programs to be a means of underlining their world presence. Although members continued to pursue political, military, and commercial aid objectives, discussion within the DAC focused almost exclusively on the more acceptable developmental objectives. A series of what were decreed "crucial problems" facing developing **countries--education**, agriculture, population growth, **unemployment**, and most recently, income **distribution--were** identified as subjects for members to give priority attention in their aid programs. The United States and other donors annually tailored

3/ These figures are based on DAC records for the total flow of official development assistance. U.S. security supporting assistance is not considered by the U.S. government or by the DAC to be official development assistance. This and all subsequent references to total world flows of economic assistance, unless otherwise specified, exclude security supporting assistance.

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their **presentations--and** to a lesser extent their aid **programs--to** meet the changing themes for development **assistance.**

Part of the response to these "crucial problems" included the establishment of special international funds and donations for these purposes to established multilateral aid channels. These efforts supplemented the steady growth of the international development banks which expanded from \$2 billion of loan commitments in 1968 to \$6.6 billion in 1974. 4/ Along with other donors, the United States increased its own contributions to multilateral aid organizations, both in absolute terms and as a percentage of total U.S. economic aid. By 1975, U.S. multilateral assistance had grown from the 5 percent of the late 1950s to 16 percent of overall U.S. economic aid.

The burden-sharing that the United States sought in the early 1960s was, in fact, accomplished with respect to the quantities of aid, if not always in its uses. **The** developing states were receiving more assistance without substantial real increases in U.S. aid. Other Western states were providing more assistance to Africa and Asia; international bodies were extending more aid to Latin America and the Near East, the regions of primary U.S. attention.

4/ World Debt Tables Volume I, Document of the World Bank, October, 1976, Table B, p. 28.

Today the United States maintains four major economic assistance programs. The programs are security supporting assistance, food assistance, and two development assistance programs: bilateral and multilateral. 1/ These programs are administered by and their budget proposals prepared in several different executive **agencies--the** Agency for International Development (AID), the Department of State, the Department of the Treasury, and the Department of Agriculture. Together, these programs account for roughly three-fifths of the international affairs function of the federal budget. In fiscal year 1977 they represented appropriations of more than \$5 billion of budget authority (see Figure 2). Loans which recipients are to repay to the U.S. Treasury account for approximately one-half of these funds.

SIZE AND STRUCTURE

Security Supporting Assistance

The largest program (budget authority of \$1.7 billion in fiscal year 1977), Security Supporting Assistance (**SA**), has in recent years represented roughly one-third of all economic assistance funds. 2/ Although SA is part of the AID budget, decisions about the use of these **funds--**

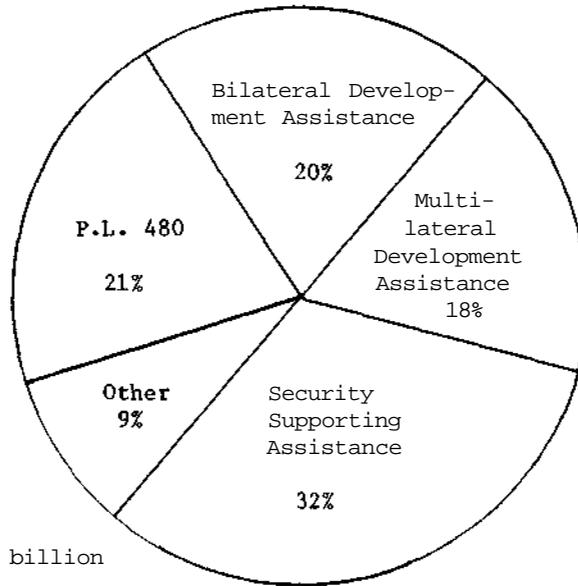
1/ Several miscellaneous economic assistance programs, including the Peace Corps, account for 9 percent of economic assistance. They are not discussed in this paper. They are included in the "other" category in Table 1, Chapter IV.

2/ Before 1974, security supporting assistance was a smaller portion of total economic assistance, but a higher proportion of other assistance funds went to the same states that received **SA**. The change appears to be primarily one of labels. For the past ten years, approximately 40 percent of economic assistance has gone to a select group of politically important **states--** either as SA alone, or as SA supplemented by development **funds**.



FIGURE 2. U.S. ECONOMIC ASSISTANCE PROGRAMS FOR FISCAL YEAR 1977 a/

As A Percent of Total Economic Assistance Budget Authority



TOTAL, \$5.46 billion

As Total Budget Authority (BA) and Total Outlays

Fiscal Year
1977 Estimate
(in billions of dollars)

Security Supporting Assistance	BA	\$ 1.74
	Outlays	1.58
Multilateral Development Assistance	BA	.96
	Outlays	1.08
Bilateral Development Assistance	BA	1.11
	Outlays	1.10
P.L. 480 (Food for Peace)	BA	1.17
	Outlays	1.01
Other	BA	.49
	Outlays	<u>.23</u>
Total Foreign Economic and Financial Assistance <u>b/</u>	BA	5.46
	Outlays	5.00

a/ CBO estimates based on the second concurrent resolution on the budget.

b/ May not **total** because of rounding.

particularly which states will receive ~~them--~~are normally made by the State Department and the White House. Frequently requested on a crisis-by-crisis basis, security assistance is used to give immediate support to U.S. diplomatic and military policies. These funds generally go to areas where U.S. policies and influence are in question. Accordingly, since 1975 the Middle East (Israel, Egypt, Jordan, and Syria) has replaced Southeast Asia as the largest regional recipient of SA. In fiscal year 1977, several nations of southern Africa (Zaire, Zambia, and Botswana) will also become recipients. SA funds also go to countries, such as Spain, that permit the United States access to their military **installations.**

The Public Law 480 Food Aid Program

The Public Law 480 food aid program has been the second largest part of U.S. foreign economic assistance. Public Law 480 loans for foreign governments' purchases of surplus U.S. agricultural commodities and grants of U.S. commodities represent about one-fifth of all U.S. economic assistance. Budget authority for these loans and grants totaled nearly \$1.2 billion in fiscal year 1977. Under this program the United States provides roughly two-thirds of the total world supply of food assistance. Initial requests from LDC governments for Public Law 480 loans or grants are discussed with U.S. agricultural attaches abroad and later submitted with the AID field budgets. The Department of Agriculture, however, determines commodity availability and chairs the interdepartmental body which allocates the commodities by country.

Development Assistance

The bilateral and multilateral development programs sponsor many of the same kinds of economic assistance efforts. The primary difference is, of course, that the bilateral program remains under direct U.S. administration, while the multilateral program provides contributions to international agencies that oversee the development projects. Comparisons of these two programs generally emphasize the relative advantages of the greater control permitted by the bilateral program and the political neutrality provided by the multilateral program. In recent years both U.S. bilateral and the multilateral programs have given greater emphasis to small-scale and rural projects

which are designed to assist the poorest groups within LDCs. The multilateral program, however, now sponsors a larger portion of large-scale, infrastructure projects intended to increase total economic production.

Bilateral Development Assistance:

Bilateral development assistance is the second largest portion of the AID budget, and also represents about 20 percent of total economic assistance. \$1.1 billion was appropriated for bilateral development assistance in fiscal year 1977. These funds are used as concessional loans and grants for development projects in four broad areas: food and nutrition; population planning and health; education and human resource development; and technical assistance, energy, and research. The bilateral development assistance program also funds American Schools and Hospitals Abroad. Most of the goods and services purchased with these funds come from the United States. A condition of development grants is that all foreign procurement be from the United States. Loans may be spent in other LDCs, but few developing countries produce the goods or services used in development projects. ^{3/} AID administers these programs on a country-by-country basis. Individual AID missions, with the concurrence of the U.S. ambassador, submit annual budget proposals to AID/Washington which are reviewed and combined on a regional and then a worldwide basis. (The bilateral development program is examined more closely in the second half of this paper.)

Multilateral Development Assistance:

Multilateral development assistance channels aid through international organizations and programs, such as the United Nations Development Program, the Organization of American States, and the new International Fund for Agricultural Development, as well as through international financial institutions such as the World Bank group, the

^{3/} Purchases from LDCs other than the recipient amount to only approximately \$20-\$25 million annually.

Inter-American Development Bank, and the Asian Development Bank. 4/

U.S. contributions to the international financial institutions (IFIs) enable these organizations to provide concessional loans and equity financing for development purposes to LDCs. 5/ Amounting to 16 percent of U.S. economic assistance, these appropriations totaled \$745.5 million for fiscal year 1977. The Department of the Treasury manages United States participation in the development banks and has primary responsibility for the budget presentations. 6/ The requested funding of IFIs is deter-

4/ The United States has not made any contributions to the International Finance Corporation since 1955. A contribution is requested, however, for fiscal year 1978.

5/ Contributions to IFIs are made in two forms: paid-in or callable capital subscriptions. Paid-in subscriptions are direct transfers to the international banks. Callable capital subscriptions are guaranteed backing for obligations the banks assume in borrowing from international capital markets. They would require outlays only if the guarantee was "called."

6/ The United States also participates in several assistance programs of the International Monetary Fund which do not require new budget authority or outlays on an annual basis. The IMF compensatory financing facility, for example, makes concessional loans to developing countries experiencing shortfalls in their foreign trade earnings. Agreement has also been reached to expand the developing countries' share of IMF quotas, while a new IMF trust fund, financed from the sale of IMF gold stocks, is being established to provide concessional financing to the poorer less developed countries. From 1974 to 1976, the IMF maintained an oil facility which provided subsidized loans to LDCs. The United States, however, did not participate in that facility.

mined primarily by negotiations among member countries and the banks' boards of governors. U.S. obligations to these agreements are not effective until Congress has approved the U.S. contribution. The requests for fiscal year 1978 contributions are considerably larger than past amounts because of several new replenishments and U.S. accumulated commitments for past **replenishments**.

Annual contributions to the U.N. Development Program (UNDP) and other international assistance programs are a comparatively small item in the AID budget: \$213 million in fiscal year 1977. They represent only 4 percent of total U.S. economic assistance. Supervision and representation is handled largely by the State Department in its Bureau of International Organization. Guidance from AID is limited. AID participates in the meetings of the UNDP governing board, and efforts are made to coordinate the AID bilateral program with U.N. assistance programs.

COMPARISON WITH OTHER DONORS' ASSISTANCE EFFORTS

At present, the United States furnishes about one-fourth of total economic assistance extended by all donor countries, considerably less than the 60 percent of 1965 and 40 percent of 1970. In 1975 official development assistance provided by all donors amounted to \$17 billion: \$13 billion in the form of bilateral assistance, and \$4 billion channeled through multilateral agencies. Of the \$17 billion total in 1975, \$4 billion came from the United States and \$9.6 billion came from other Western donors, primarily France, West Germany, Japan, Canada, and the United Kingdom. The remainder came from Communist states and from the OPEC states which began substantial assistance efforts in 1974. Communist states contributed approximately \$0.7 billion and OPEC states about \$2.7 billion in 1975. 7/ Most of their assistance was given bilaterally.

7/ Source: OECD Development Assistance Committee, as reported in the IMF Survey, July 19, 1976. OECD figures represent amounts of aid disbursed (less receipts) in a calendar year, rather than amounts appropriated for a fiscal year. Figures for aid from the Soviet Union and China do not include aid to Cuba or the Democratic Republic of Vietnam, for which no reliable information is available.

The aid programs of the United States are more varied and diverse than are those of other donor states. Most other Western donors provide aid as either bilateral development or multilateral development assistance. No other Western donor has a security supporting assistance program comparable to that of the United States. While other donors provide food assistance within their development programs, none furnishes as much food aid as does the United States under its Public Law 480 program nor does any other donor give as much of its total economic assistance in the form of food aid. In fiscal year 1977, about 45 percent of U.S. bilateral development funds were directed at problems in the areas of rural development and food and nutrition; no other donor directs more than a third of its bilateral aid to problems in this area.

The United States also focuses a larger portion of its bilateral development aid upon population control projects than other donors. At present, the United States is responsible for more than 90 percent of all Western sponsorship of population control in developing countries.

Other Western states also have unique aid activities. Canada and Holland, for example, include in their foreign aid budgets compensation to domestic producers for losses incurred as a result of increased imports from LDCs.

Each of the major aid ~~donors--Western~~ states, international **organizations**, communist states, and OPEC **states--** directs its assistance towards somewhat different geographical regions. Western states, other than the United States, tend to concentrate their efforts in Africa or the Far East. The smallest proportion of their aid goes to Latin America, the one region in which the United States has most consistently been the largest single donor. The geographic distribution of assistance activities by international agencies and financial institutions is far more similar to the United States. The greatest portion of their resources are equally divided between Latin America and the Near East/South Asia. The Near East/South Asia is the most rapidly growing area for both United States and multilateral assistance. Africa and East **Asia--the** regions which obtain the least **U.S. aid--each** receive approximately half the international assistance of either Latin America or the Near East/South Asia. OPEC assistance is concentrated in the Near East and South Asia. Economic aid from the Soviet Union and Eastern European states is given almost ex-

clusively to those states with which Moscow maintains or is pursuing close political relations: India, Afghanistan, Bangladesh, Guinea, Syria, Iraq, Mali, Benin, Pakistan, Somalia, Tanzania, and Yemen. (No information is available for Cuba and Vietnam, but these are presumably two of the largest recipients of Soviet aid.) Peking still directs most of its assistance to Africa, although that region's portion of total Chinese commitments is declining. The major recipients of Chinese assistance outside of Africa are found in Southern Asia: Afghanistan, Laos, and Pakistan. Communist states' assistance tends, then, to go to competing client states rather than to overlap in the same recipient as U.S. aid. The exceptions are primarily Asian states along the Soviet **perimeter.** 8/

Although other donors individually provide less total aid than does the United States, they concentrate their aid upon fewer recipients and often upon a more homogeneous group of recipients. France, for example, gives priority to French-speaking African states. A large proportion of French aid is spent on education projects in those countries (more than half of all foreign teachers in developing countries are French). Similarly, Japanese aid is directed toward countries from which Japan imports raw materials and is often tied to the production of those raw materials. The Canadian aid ministry attempts to concentrate upon countries where Canadian expertise in agriculture, transportation, and hydroelectric power can best be utilized. The United Kingdom provides the majority of its economic assistance to Commonwealth countries. Holland and Belgium direct most of theirs to former colonies.

The relative concentration of some other donors' assistance **efforts** results in aid **transfers** per recipient that are greater than those from the United States, even though the United States gives **significantly** more total aid than any other donor. The average U.S. bilateral develop-

8/ Organization for Economic Cooperation and Development, Development Cooperation 1975 Review (Paris: 1976), pp. 175-9. Central **Intelligence Agency**, Research Aid; Handbook of Economic Statistics (Washington: 1975), pp. 61-70.

merit aid transfer to each recipient is under \$25 million.
9/ For other major donors the figures for bilateral development aid per recipient country are as follows: France, \$47 million; West Germany, \$29 million; Japan, \$25 million; Canada, \$20 million; United Kingdom, \$17 million; and Sweden, \$12 million.

9/ The total U.S. aid transfer per recipient for all bilateral programs except security supporting assistance is slightly higher: \$28 million. Inclusive of security supporting **assistance--for** which no other donor has a comparable aid **category--U.S.** assistance rises to \$47 million per recipient.

CHAPTER IV ASSESSING BILATERAL DEVELOPMENT ASSISTANCE

Any assessment of U.S. economic assistance begins with the problem of multiple, vague, and sometimes conflicting aid objectives, and of establishing standards for judging success or failure of the programs. The Executive Branch, the Congress, and the public hold varied expectations of what aid should accomplish. The objectives most often ascribed to economic assistance programs include the reduction of immediate hunger and misery and the promotion of long-term general prosperity and growth. Many other goals are also held: promotion of economic and political stability; support for specific diplomatic or military objectives; creation of markets for U.S. goods and services; assuring U.S. access to raw materials; promotion of amicable relations with recipients; and continued access to leaders of recipient governments.

In many cases, these objectives are **complementary**. Relieving hunger and sickness in recipient countries, for example, may also contribute to economic and political stability. In other cases, the economic and political objectives of the various programs may conflict. Financial support provided by the United States for security purposes may be spent by a recipient government in ways which are detrimental to the poorest groups within that country.

The remainder of this study examines the one major economic assistance program whose objectives have been specifically defined by Congress: the bilateral development program. As far as is possible, the **effectiveness** of this program is evaluated in terms of the relevant legislation expressing Congressional intent for the program. While attention is given to only one of the four major U.S. economic assistance **programs--bilateral** development **assistance--much** of the analysis is also relevant to an evaluation of the other economic aid programs. Multilateral development assistance and Public Law 480 food aid also are typically aimed at many of the same problems, and generally encounter the same **difficulties**. Much of what **can--and cannot--be** said about the **effectiveness** of bilateral development aid also applies to other economic assistance programs.

NEW DIRECTIONS: A NEW FOCUS

In the Foreign Assistance Act of 1973, the Congress provided a very specific statement of the objectives of U.S. bilateral development aid. This statement was a major reorientation of U.S. bilateral aid **policy--away** from a strategy of promoting growth through large development projects in industry and **infrastructure**, to programs intended to benefit directly the poorest peoples in developing countries. In the International Development and Food Assistance Act of 1975, Congress strengthened the provisions of the "New Directions" policy and also applied them to the Public Law 480 food aid program.

The New Directions mandate was a reaction to the apparent failure of past assistance efforts to reach the poorest groups within recipient countries. Although many developing countries' economies grew **significantly** in the 1960s, growth in per capita income was often accompanied by a worsening distribution of national income. 1/ Although economic growth raised mean incomes, the shares of total national income going to the poorest segments of the populations declined. It is important to realize that although they are relatively worse **off**, average incomes even for the poorest have in most cases risen to some degree. As a rule, however, it has been found that the income distribution deteriorates up to a point where per capita GNP reaches about \$350 and then gradually improves with continued growth. 2/ Because most developing countries have per capita GNPs below this level, they are presumably in a stage of deteriorating income distribution.

The basic precept of the New Directions in bilateral development assistance is that:

1/ Hollis Chenery and Moises Syrquim, Patterns of Development 1950 - 1970, Oxford University Press, 1975; Irma Adelman and Cynthia T. Morris, Economic Growth and Social Equity in Developing Countries, Stanford University Press, 1973.

2/ See Montek S. Ahluwalia, "Income Distribution and Development: Some Stylized **Facts**," American Economic Review, May 1976.

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"United States bilateral development assistance should give the highest priority to undertakings submitted by host governments which directly improve the lives of the poorest of their people and their capacity to participate in the development of their countries.

"Greatest emphasis shall be placed on countries and activities which effectively involve the poor in development, by expanding their access to the economy through services and institutions at the local level, increasing labor-intensive production, spreading productive investment and services out from major cities to small towns and outlying rural areas, and otherwise providing opportunities for the poor to better their lives through their own effort." 3/

The guidance for the use of bilateral development funds is quite detailed, both in terms of objectives and **means**. In the area of food and nutrition, aid is to be focused on projects designed to increase the productivity and income of the rural poor, particularly small **farmers**, who constitute the majority of population in most developing countries. 4/ Population planning and health assistance is to be used primarily for the extension of low-cost, integrated delivery systems for providing basic health and family planning services. 5/ Assistance in the area of education and human resources development is intended to expand and strengthen non-formal methods of education, as well as to increase the relevance of formal education to the needs of the poor. 6/

NEW DIRECTIONS; NEW ASSISTANCE USES

The New Directions mandate does seem to have resulted in a partial shift from large-scale industrialization

3/ Foreign Assistance Act of 1961, Sec. 102(b)(5) and Sec. 102(c), (as amended in 1973).

4/ Ibid., Sec. 103(b), (as amended in 1975).

5/ Ibid., Sec. 104(b), (as amended in 1975).

6/ Ibid., Sec. 105(b), (as amended in 1975).

projects to smaller-scale projects in the area of rural development, health, and education. Although large, capital-intensive projects persist, some at the insistence of LDC governments, they represent a smaller portion of new program commitments than in the past. Under the Congressional mandate, food production, rural development, and nutrition projects rose from 26 percent of total AID functional development activities in 1973 to 61 percent in 1976. According to AID, efforts to improve the diets of the poor were increased during this period at the expense of other **activities--such as heavy industrialization projects--** which were considered less likely to provide direct and immediate benefits to the very poor.

At the individual project level, an increasing proportion of AID activities seems to be consistent with the New Directions emphasis on assistance to the poorest peoples in recipient countries. A review of 160 AID projects proposed for fiscal year 1977 found that 32 percent of the projects appear to be fully consistent and 96 percent at least partly consistent with the provisions of the **New Directions** legislation. 7/ In fiscal year 1975, 26 percent of AID projects appeared to be fully compliant with the New Directions guidelines, 9 percent fully complied in fiscal year 1973, and 8 percent did in fiscal year 1970. 8/ Only 4 percent of AID projects appear to be clearly inconsistent with the New Directions guidelines in fiscal year 1977. In fiscal years 1975, 1973, and 1970, 9, 21, and 32 percent of AID projects respectively were found to be in direct conflict to the New Directions mandate (see Table 1). Such measurements may not be a valid reflection of changes in bilateral development activities. It is possible that some of the changed emphasis merely represents changes in the ways bilateral development projects are described to the

7/ R. L. Prosterman and C.A. Taylor, "Grading Bureaucratic Compliance: A Briefing Paper on AID's FY 1977 Presentation to Congress," (**unpublished**), March 1976. This review and the subsequent CBO review for 1970, 1973, and 1975 did not cover all AID projects but only those projects costing more than \$1 million.

8/ These figures were obtained by a separate CBO review which employed the **Prosterman-Taylor** criteria and methodology.

Congress. Nonetheless, the shift is so large that it seems quite likely that the New Directions policy has resulted in **significantly** greater emphasis upon projects designed directly to benefit the poorest peoples in recipient countries. It is still too early, however, to judge whether the New Directions policy will result in a long-term **refocusing** of U.S. aid efforts or simply become another in the series of changing themes for developmental aid.

TABLE 1. EVALUATION OF AID FUNDED PROJECTS FOR COMPLIANCE WITH "NEW DIRECTIONS" GUIDELINES a/

Ratings	<u>Percent of Projects in Each Category</u>			
	Fiscal Year 1970	Fiscal Year 1973	Fiscal Year 1975	Fiscal Year 1977
Fully Compliant (4)	8	9	26	32
Minor Inconsistency (3)	16	19	34	28
Partial Inconsistency (2)	17	35	19	23
Major Inconsistency (1)	27	17	12	13
Direct Conflict (0)	32	21	9	4
Average Rating (maximum: 4.0)	1.4	1.8	2.6	2.7

Source: For fiscal year 1977, R. L. Prosterman and C.A. Taylor, "Grading Bureaucratic Compliance: A Briefing Paper on AID's FY 1977 Presentation to Congress," (unpublished), March 1976. For fiscal years 1970, 1973, and 1975, a CBO review using the Prosterman-Taylor methodology.

a/ Samples include only those projects costing \$1 million or more.

NEW DIRECTIONS AND OTHER DONORS

The United States is not alone in adopting a New Directions-type theme for developmental aid. Other donor countries and international agencies have also adopted aid policies intended to benefit the poorest LDCs and the poorest groups within LDCs. The DAC strongly encourages such policies and now measures its members' aid performance not only in terms of how much they give but also in terms of how much of this assistance is directed towards helping "the poorest." 9/ The DAC and its members have not, however, been able to agree on standards by which performance in assisting the poorest can be measured. For most DAC members, assistance loans for the poorest LDCs have become slightly more concessional and the character of assistance projects has shifted to smaller-scale, rural **activities**. These changes indicate increased assistance to the poorest only if the loans and projects reach the poorest groups within the recipient **countries--a** result which is difficult: to demonstrate or to measure. The DAC and most of its members tend to emphasize the criterion of how much **assis-**tance is going to the poorest LDCs, in part because this is far easier to measure than how much is going to the poorest: peoples. 10/

The increase in assistance to the poorest LDCs seems to be closely associated with total increases in assistance. While aid is apparently not being reduced to other countries, a large portion of new or additional aid is going to the poorest recipients. Between 1974 and 1975 the amount

9/ All but two members of the seventeen DAC members have officially embraced policies which would give priority either to helping poorer peoples within LDCs or the poorest states among LDCs. The two abstainers, however, are also two of the largest donors: France and Japan. Paris and Tokyo have not been induced to direct most assistance to the "poorest," despite the official proddings of the DAC organization and other **donors.**

10/ Several definitions are used for the poorest LDCs: those most seriously affected (MSA) by the rise in petroleum prices, those with per capita income less than \$250, and those with per capita income less than \$350.

of aid extended by all donors to countries with per capita GNPs of \$250 or less increased by more than \$2 billion. The donor countries having the best records for increasing aid to poor countries are also those that have most increased their overall levels of aid in recent years. Canada and Sweden, for example, have two of the highest rates of growth in total foreign aid and also two of the highest proportions of aid to the poorest LDCs. The United States, which has had only a very moderate real increase in assistance, has also had only a moderate shift towards the poorest LDCs. This may be partly because the U.S. program, more than others, emphasizes assisting the poorest groups rather than the poorest states. Nonetheless, in 1975 approximately half of U.S. food and bilateral developmental aid--the two programs subject to New Directions--went to LDCs with per capita incomes of less than \$300.

The agreement among Western aid donors that more aid should be provided to the poor does not appear to have **significantly** increased the amount of coordination among major aid donors or substantially changed the distribution of Western aid. The common theme has not been translated into common practice because too much confusion exists about who the poor are, about the amount of assistance actually being redirected to them, and about the best use of foreign aid to improve their lives.

NEW ASSISTANCE RESULTS

How effective are present AID activities in improving the welfare and productivity of the poorest peoples in recipient countries, as called for by the New Directions mandate? In relation to the problems in developing countries of poverty, **unemployment**, malnutrition, and ill health, the size of the U.S. aid effort is quite small. In most recipient countries U.S. development assistance amounts to considerably less than 1 percent of GNP, or about \$.40 per person. 11/ U.S. aid does reach some poor people

11/ It has been calculated that total aid from all DAC countries accounts for only about 8 percent of the **growth rate** of GNP in developing countries. Marian Radetzki, Aid and Development; A Handbook for Small Donors (New York: Praeger), 1973, p. 78. Security supporting assistance is included in this calculation.

and at least temporarily raises their incomes. Credit is extended to small farmers who previously **would** not have qualified for loans. Irrigation projects are increasing the arable land available to small farmers. **Food-for-work** projects, which will provide jobs for unemployed rural workers, are being conducted in several recipient countries. While not a "new" aspect of U.S. assistance, population planning projects do reach the poor directly and do, on a very small scale, reduce the rate of population **increase**. The numbers of people reached by aid projects, or the extent: of direct benefits provided are, however, dwarfed by the magnitude of the overall problems involved.

AID projects in and of themselves can produce either significant benefits for a few, or less significant, temporary benefits for many. For this reason U.S. aid, by itself, cannot be expected to bring about major changes in the welfare and income of large numbers of the poorest peoples in developing countries. Permanent improvements in the productivity, employment, and well-being of the majority of the poor depend **fundamentally** upon the economic and social policies of the governments of developing countries themselves. The experiences of a few countries, such as Taiwan and South Korea indicate that, with the right combination of government policies, economic growth accompanied by a redistribution of income is possible, even at per **capita** GNP levels below \$350. The **effectiveness** of U.S. aid, then, must be judged not only by its direct and immediate effects, but also by the extent to which it facilitates appropriate LDC government policies that contribute to widely shared growth. Development, particularly the broadly distributed development envisioned by the New Directions objectives, is a long-term process. It is on the basis of its long-term effects that U.S. aid must finally be judged.

The long-term achievement of the goals of development assistance depends, then, primarily upon the degree to which recipient governments can be encouraged to adopt domestic development policies favorable to the poor. The United States can encourage recipients to adopt such policies by requiring an explicit **quid pro quo** in exchange **for** aid, by relieving the LDCs of some of the costs of moving from one policy mix to another, by funding demonstration projects and persuading recipient governments to adopt similar measures on a broad scale.

POLICIES AVAILABLE TO LDC GOVERNMENTS

A number of policy instruments are available to LDC governments for combating the problems of poverty, unemployment, and unequal distribution of income. The appropriate policy mix will, of course, differ with the economic, social, and political conditions in each country. For almost all LDCs, however, the most important policy areas are rural development, employment, health, and education.

Rural Development

Rural development measures can increase the productivity of the rural poor. A major constraint on the productivity of the rural poor is a lack or shortage of land. In countries where land holdings are distributed unequally, primarily in Latin America, land reform may be an appropriate government policy. Since small, labor-intensive farms are often capable of per acre yields as high or higher than those on larger, mechanized farms, the danger of reducing overall agricultural output as a result of land reform is reduced. In some countries, such as Brazil, it has been estimated that land reform might increase total farm output by as much as 20 percent. ^{12/}

Land reform, however, must be accompanied by provision of management, technical, or other services or inputs to be of immediate benefit to the small farmer. Extension programs in management and crop technology are one such service. The World Bank has estimated that small farmer yields in Tanzania, for example, could double without any additional investments or inputs, simply by improving cropping techniques. Credit is another service required by small farmers. It is estimated that small farmers in some countries

^{12/} This estimate was based on calculations for a "total reform" requiring reallocation of all available land and labor. The estimate for a less complete "partial reform" was considerably lower, a 6 percent increase in farm production. William R. Cline, Economic Consequences of a Land Reform in Brazil (London: North Holland Publishing Company), 1970, pp. 178-81.

spend only about 20 percent of what they otherwise would on farm inputs if they had better access to credit. 13/

Employment Policies

LDC governments might promote employment in the industrial sector in several ways. By raising interest rates or working to limit wage increases in the modern sector, for example, governments might shift investment: toward more labor-intensive methods of production. A low wage policy, however, will usually encounter strong opposition from those already **employed--an** important constituency in most developing countries. Low wages would also seem to require that food prices to urban wage earners **be** kept low, creating a dilemma for agricultural pricing policy.

The most successful examples of employment creation in developing countries (South Korea, Taiwan) have involved policies to promote labor-intensive, manufactured exports. Export promotion is one way of utilizing an abundant **re-**source in which most LDCs have a comparative advantage: relatively cheap, semi-skilled labor. It also solves the problem of finding an outlet for manufactured goods by taking advantage of foreign markets.

Korea initiated a policy of export promotion in the mid-1960s by increasing the interest rate, devaluing its currency by 50 percent, reducing income taxes on profits earned from exports, reducing the duties on imports of equipment to be used in the manufacture of exports, and offering preferential electricity and transport rates to export industries. Between 1964 and 1970, measured unemployment rates in Korea dropped from 7.7 percent to 4.5 percent as export industries boomed in response to these policies.

Similar policies followed by Taiwan during the 1960s resulted in annual increases in the amount of industrial

13/ U.S. General Accounting Office, Disincentives to Agricultural Production in Developing Countries, November 26, 1976.

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exports of almost 20 percent. ^{14/} Increases in exports also result in increases in the demand for supporting services, raw materials, and component supplies. It is estimated that during the 1960s in Korea, every \$1 million increase in exports resulted in 500 new jobs per year in export industries and 150 new jobs per year in supporting services. ^{15/}

Health and Education Policies

Health and education policies are also important for improving the welfare of the poor, as well as for increasing their **productivity**. The creation of employment opportunities has little meaning without healthy people possessing the basic skills to take advantage of them. In general, health and education benefits in developing countries have been skewed toward the upper income groups. Only about 20 percent of health expenditures in LDCs are directed at preventive medicine. The other 80 percent are allocated to curative medical practice that is usually concentrated in urban areas and often priced beyond the reach of the poor. ^{16/} More sanitation, preventive medicine, small clinics, and out-patient facilities would provide more help for the poorest. Tanzania and some other LDCs have reportedly been successful in distributing such health services to the poor.

Education expenditures have also tended to discriminate against the poor; developing countries generally allocate a larger proportion of education budgets to higher education

^{14/} John C. H. Fei and Gustav Ranis, "A Model of Growth and Employment in the Open Dualistic Economy: The Cases of Korea and Taiwan," Yale University Economic Growth Center Paper No. 233, 1976.

^{15/} Robert E. Looney, Income Distribution Policies and Economic Growth in Semi-Industrialized Countries (New York: Praeger), 1975, p. 141.

^{16/} D.C. Rao, "Urban Target Groups," in Chenery, et. al, Redistribution with Growth, Oxford University Press, 1974, annex.

than industrialized countries, even though a much smaller percentage of students reaches high school in LDCs. 17/ To benefit the poor, education should be made more accessible, in terms of both location and cost.

U.S. ASSISTANCE AND GOVERNMENT POLICIES IN LDCS

The United States might attempt to encourage recipient governments to adopt appropriate, long-term development policies favorable to the poor in several ways: by requiring explicit quid pro quo changes in LDC policies in return for U.S. aid; by relieving LDCs of some of the foreign exchange and other financial costs of moving from inappropriate policies; by finding and demonstrating effective methods of benefiting the poor and encouraging recipient governments to adopt similar methods on a broad scale; and if possible, by facilitating the adoption of **employment-intensive** methods of production in LDCs.

The ability of AID to influence policy choices in LDCs is limited not only by the size of the aid program, but: also by a reluctance to appear to be interfering in the host country's political decision-making. The New Directions legislation states specifically that "development planning must be the responsibility of each sovereign country." Without a substantial commitment on the part of key leaders of a recipient government to improving the lives of the poor, there is really very little U.S. **assistance** can change.

The extent to which U.S. assistance contributes to effective policies in developing **countries**, and indirectly through those policies to development, varies from country to country and is difficult to measure, particularly in terms of macroeconomic objectives of growth and income distribution. Even in countries such as Korea and Taiwan, where the volume of **U.S.** assistance has been large, 18/

17/ Frederick H. Harbison, "Education and Income Distribution," Policy Research Workshop, **Princeton** University, October 1973.

18/ Economic assistance to Korea has amounted to \$5.6 billion since 1946. Economic assistance to Taiwan has totaled \$2.2 billion. Source: AID, U.S. Overseas Loans and Grants, 1976.

accurate information on the relationship between aid and changes in government policies is limited, although it does appear that U.S. influence played a role in a few key decisions. 19/

Assistance as a Quid Pro Quo

Assistance can influence developing countries' policies by predicating grants or loans desired by a recipient government upon specific changes in that government's development programs. This quid pro quo practice is followed by AID to ensure that aid funds are used effectively, as well as to encourage appropriate changes in LDC government policies. In **Honduras**, for example, AID has conditioned a recent \$1.2 million loan for rural development upon steps toward land reform. In return for a \$12 million agricultural-sector loan to the Dominican Republic, AID has received promises that interest rates will be increased from 8 to 11 percent, in order to make available more credit for the small farmer. By encouraging policy changes in this way, development assistance can indirectly benefit a substantial number of poor people in developing countries.

Assistance as a Financial Resource

Assistance can also facilitate the adoption of appropriate policies in developing countries by helping to ease the foreign exchange and other resource shortages which constrain the policy options available to LDC governments. Most governments in developing countries, or at least elements in those governments, have made some commitment to improving the lives of the poor in their countries, whether for humanitarian, social, or political reasons. Governments cannot always fulfill these commitments, however, because resources in developing countries are limited. An expanded rural health program, for example, might compete for scarce resources with urban hospitals; some hospitals might have to be closed down if rural health care were expanded. Such a decision may not **be** politically acceptable to LDC governments. By providing a small but appropriately targeted amount of financing, U.S. aid may encourage recipient governments to pursue particular programs that help the poor.

19/ See Joan M. Nelson, Aid, Influence, and Foreign Policy (New York: Macmillan Company), 1968, Chapter 4.

Assistance can also be helpful in assuaging legitimate fears about the short-term consequences of certain policy reforms. For example, government officials might be concerned about the effects that tariff reductions associated with an export promotion policy might have on government revenues. The costs of importing certain industrial goods necessary for the manufacture of labor-intensive exports might also inhibit governments from moving in the direction of export promotion. The large grants of U.S. aid to Korea and Taiwan during the early 1960s almost certainly facilitated the transition to a policy of export promotion in those countries. 20/

Similarly, the availability of concessional financing and technical support from AID can encourage LDC governments to increase their own expenditures in a certain **area**. Between fiscal year 1974 and fiscal year 1976, for **example**, when AID loans to Ethiopia for use in the agricultural sector amounted to \$32 million, the Ethiopian government: increased its own agricultural development budget by 135 percent. Agricultural-sector loans to Costa Rica and Chile have also encouraged the governments of those countries to allocate a larger share of investment and credit to agriculture and rural areas.

The Demonstration Effects of Assistance

U.S. assistance may make an important contribution by finding, **testing**, and demonstrating effective methods reaching and benefiting the poor. When such methods are adopted and practiced by LDC governments themselves on a wide scale, the long-term impact of aid can be greatly increased.

In the area of rural development, aid projects can be useful in demonstrating how small farmer productivity can be increased with new varieties of seed, different cropping techniques, and access to other inputs such as fertilizer and credit. A proposed \$3 million pilot fisheries development project in Indonesia is one example of how aid can be used to demonstrate new ways of increasing the productivity of the rural poor. The project is designed to contribute to improved nutrition and farm incomes by establishing modern

20/ See Gustav Ranis, "Taiwan," in Hollis **Chenery**, et al., Redistribution with Growth, **op. cit.**, annex.

brackish-water fish farms utilizing advanced fish-culture practices on presently unused land in South Sumatra. The **beneficiaries** are intended to be poor fish farmer families who will be relocated from overcrowded areas of Java.

Aid projects can also demonstrate the necessity and feasibility of providing small farmers with a basic infrastructure, including irrigation, electricity, feeder roads, and markets. These objectives may be best achieved through the use of local cooperatives or farmers' associations, and AID's role in encouraging these organizations can be significant. In Taiwan, for example, U.S. aid channeled through the Joint Commission on Rural Reconstruction in the 1950s and early 1960s helped to strengthen and assist the irrigation **associations**, which presently maintain and manage Taiwan's irrigation facilities, fertilizer distribution, and extension services. Today, these associations provide benefits to over 90 percent of the small farmers in Taiwan and are instrumental in that country's high level of agricultural productivity and balanced growth. The creation of rural **electrification** cooperatives in the Philippines has been another successful experiment made possible by U.S. aid. The cooperatives have helped to provide cheap electricity to over 100,000 rural families. **Electrification** has brought the advantages of pure and safe water through construction of water systems based on electric water pumps and piping. 21/

The ultimate success of such research and demonstration projects **depends**, of course, on appropriate follow-up by recipient countries. Such follow-up is uncertain.

Assistance and Employment Creation

To help create employment **opportunities**, aid could be used to encourage and assist in the adoption of more labor-intensive methods of production. These methods would involve technologies appropriate to conditions of surplus labor. Recent studies suggest that in several industries in developing countries, labor-intensive production techniques could be adopted by large companies

21/ In fiscal year 1977 additional support of \$20 million is proposed by AID for the expansion of these cooperatives.

as well as small businesses without any sacrifice in overall efficiency or increase in average unit production costs. 22/ Examples include the production of tube wells in India, lift pumps in Vietnam, and the manufacture of paper in Mexico. In some cases, particularly where protected domestic markets have inhibited competition and led to monopoly situations, a switch to more labor-intensive methods of production may even result in greater efficiency or lower unit production costs.

The adoption of more labor-intensive methods of production in developing countries depends in part upon a change in government policies that have distorted factor prices, reduced or eliminated competition, and discriminated against smaller businesses. These include the insulation of monopoly producers from the market consequences of high-cost production methods, low government-subsidized interest rates to favorable borrowers, favorable exchange rates and low tariffs on imported capital goods, licensing requirements, tax holidays on new investments, and accelerated depreciation on capital goods. Policies that made labor in urban manufacturing more expensive through minimum wage legislation, mandated fringe benefits, and restrictions on the ability to lay off or retire workers also tend to reduce employment. Evidence on the substitutability of labor for capital in some LDC industries indicates that changes in the relative prices of capital and labor encourage the adoption of more labor-intensive methods of production. 23/ Assistance from the United States, in the form of either economic

22/ International Labor Organization, Employment, Growth and Basic Needs: A One-World Problem, Geneva, 1976; Lawrence J. White, "Appropriate Factor Proportions for Manufacturing in Less Developed Countries: A Survey of the Evidence," paper prepared for AID, April 1976; Howard Pack, "Policies to Encourage the Use of Intermediate Technology," paper prepared for AID, April 1976.

23/ Werner Baer, "Technology, Employment and Development: Empirical Findings," World Development, February 1976; Louis T. Wells, Jr., "Economic Man and Engineering Man: Choice of Technology in a Low Wage Country," Public Policy, vol. 21, no. 3, Summer 1973; White, op. cit.

and policy analysis or quid pro quo loans and grants, could encourage those necessary changes in LDC government **policies.**

Industries are more likely to respond to changes in the relative prices of capital and labor where they have information about and access to labor-intensive technologies, as well as the managerial skill and know-how to adopt those technologies efficiently. Here aid can play an important role. First, aid might be used to sponsor research into new labor-intensive production techniques. Second, aid could be used to establish and support industrial extension services in developing countries to help disseminate information on new production techniques and provide assistance in the adoption of those techniques.

A review of AID projects over the last few years indicates that very few resources have been devoted to the creation of employment opportunities in the industrial sector. In fiscal year 1977, less than \$5 million is proposed for research in the area of intermediate or appropriate technology.

In the International Development and Food Assistance Act of 1975, Congress has called upon AID to allocate a minimum of \$20 million over fiscal years 1976, 1977, and 1978 for grants "to promote the development and dissemination of technologies appropriate for developing countries." 24/ Appropriate technology, for the purpose of this provision, has been defined by the House International Relations Committee as "tools and machines that are suited to labor-intensive production and fit small farms, small businesses, and small incomes." 25/ AID is in the process of formulating a program in appropriate technology. It has indicated that the program will be oriented toward rural development as well as employment creation in the industrial

24/ International Development and Food Assistance Act of 1975, Section 107.

25/ U.S. House of **Representatives**, House International Relations Committee, International Development and Food Assistance Act of 1975 (Report to accompany H.R. 9005), 94th Congress, 1st session, August 1, 1975.

sector. ^{26/} AID has also proposed the establishment of an **AID-sponsored** private Appropriate Technology Fund to encourage innovations in appropriate technology, evaluate appropriate technology projects and programs, and help transfer selected information about appropriate **technology**.

26/ Agency for International Development, Proposal for a Program in Appropriate Technology, July 27, 1976, pp. 26-27.

CHAPTER V BUDGET OPTIONS FOR BILATERAL DEVELOPMENT
ASSISTANCE

Adjustments in the levels of bilateral development assistance spending need not be associated with any specific changes in bilateral assistance policy. Within almost any level of funding, a wide variety of programs and recipients is possible. Changes in bilateral development assistance funding may, however, affect overall economic assistance policy to the extent that they emphasize or **deemphasize** this program relative to the others: security supporting assistance, Public Law 480 food assistance, and, particularly, multilateral development assistance.

Multilateral development assistance is generally considered to be the primary alternative to bilateral development assistance. The international financial institutions (**IFIs**)--whose contributions comprise most of U.S. multilateral development **expenditures--attempt** to achieve many of the same development objectives through loans which sponsor many of the same activities as the bilateral program. Like the U.S. aid program, the lending banks have in recent years given greater emphasis to projects designed to benefit the poor. In fiscal year 1978, an accumulation of past commitments and new obligations to these institutions raises the possibility of greatly increased multilateral development funding. If the Congress appropriates funds sufficient to meet U.S. authorized contributions and to begin the requested new subscriptions to the IFIs, multilateral development assistance could increase to \$1.8 billion in budget authority, nearly a 90 percent rise from fiscal year 1977. 1/ An important budgetary question

1/ The \$1.8 billion multilateral development assistance figure is used here as a moderate estimate of the costs of meeting all old and new **U.S.** obligations to the IFIs. The Congress may, of course, choose to appropriate greater or lesser amounts. (Full funding of the Ford Administration request would, for example, require \$400 million higher funding.) These considerations are discussed in a forthcoming CBO background paper on international financial institutions.

in fiscal year 1978 will be how to treat bilateral development in the light of a potential, sudden increase of U.S. multilateral development assistance. The Congress may wish to offset an increase in these contributions to international **IFIs** with a cut in bilateral funds, thereby **deemphasizing** the bilateral program in favor of multilateral development efforts. The Congress could, however, choose to maintain the present balance between bilateral and multilateral development assistance efforts and make an equivalent increase in the bilateral aid program. Either option would require a substantial variation from current policy funding for bilateral development assistance (see Table 2).

CURRENT POLICY

To maintain the fiscal year 1977 real level of bilateral assistance in fiscal year 1978, a 5 percent increase in appropriations to \$1.2 billion will be required. If multilateral development funding increased to \$1.8 billion and the other assistance programs were held at current real levels, total economic assistance would rise from \$5.5 billion in fiscal year 1977 to \$5.8 billion in fiscal year 1978.

LOW OPTION

Bilateral development assistance would have to be reduced by 50 percent if its funding is adjusted to offset the potential increase in multilateral assistance. A bilateral assistance program of \$555 million would permit the increase in multilateral contributions to be achieved without going beyond the total current policy projection for economic assistance of \$5.2 billion. This would disrupt the budgetary balance between the bilateral and multilateral programs and treat the multilateral program as a preferred alternative. For the bilateral program, this could mean that either the average transfer per recipient state would be sharply reduced or the number of recipient states would be reduced. To maintain the current number of 47 recipients, the average transfer would be cut from the fiscal year

TABLE 2. ADJUSTING BILATERAL DEVELOPMENT ASSISTANCE TO AN INCREASE IN MULTILATERAL DEVELOPMENT ASSISTANCE: THE THREE OPTIONS AND THEIR EFFECT ON THE TOTAL ECONOMIC ASSISTANCE FUNCTION

	Bilateral Development Assistance (In Millions of Dollars)	Percent Change From Fiscal Year 1977	Total Economic Assistance (In Millions of Dollars)	Percent Change From Fiscal Year 1977
FY 1977 Estimate:	\$1,113	--	\$5,460	—
FY 1978 <u>a/</u> Current Policy:	1,173	---	5,211	
FY 1978 Options For Bilateral Development Assistance:				
Current Policy	1,173	5	5,829	7
Low Option	555	-50	5,211	-5
High Option	1,781	60	6,437	18

NOTE: For fiscal year 1978, **multilateral** development assistance is projected at \$1.8 billion (the estimated increase), other non-development programs are projected at fiscal year 1977 real levels, and bilateral assistance is varied according to three options.

a/ CBO current policy projections for security supporting assistance show an increase from \$1.7 billion to \$1.8 billion. For P.L. 480, however, the projections show a decrease from \$1.1 billion to \$0.8 billion because of excess budget authority for fiscal years 1976 and 1977.

1978 current policy level of \$25 million to \$11 million. 2/ A constant average transfer could be maintained if recipient countries were reduced to 22. Such a reduction could be achieved by limiting assistance to countries with immediate importance to the United States or to governments which are now pursuing domestic developments consistent with New Directions. This reduction might also be effected by discontinuing U.S. assistance to some of the LDCs with middle or higher range per capita income.

HIGH OPTION

Bilateral development assistance could be increased by 60 percent and the balance between the two development programs maintained. This would mean \$1.7 billion in bilateral development assistance. Appropriations for all economic assistance would then total \$6.4 billion. The more than \$600 million increase in bilateral assistance funding could be used to sponsor additional development programs that seem likely to contribute to New Directions objectives. This could include projects designed to promote exports of employment intensive goods (see Chapter IV). The increase would permit an enlargement of the average per country transfer from \$25 million to \$38 million and potentially reinforce U.S. leverage to encourage LDC governments to pursue appropriate development programs. **Alternatively**, if the current distribution of funds among recipients is maintained, this increase could permit the addition of as many as 23 more LDCs. It could be used to increase assistance in regions such as southern Africa where U.S. bilateral development efforts have been small in the past or to extend more U.S. assistance to the poorest of the LDCs.

2/ The distribution of bilateral development funds, of course, varies widely from the average transfer. This figure is used here simply as a measure of the magnitude of changes in total funding levels. While an average per capita transfer might be more meaningful, that **figure** would depend primarily upon which particular recipients were kept discarded, and added as total funding falls or increases.



GLOSSARY OF ABBREVIATIONS

AID:	Agency for International Development
DAC:	Development Assistance Council (assistance coordinating body within the Organization for Economic Cooperation and Development)
IBRD:	International Bank for Reconstruction and Development (the World Bank)
IDA:	International Development Association
IDB:	Inter-American Development Bank
LDC:	Less Developed Country
OECD:	Organization for Economic Cooperation and Development
P.L. 480:	Public Law 480 (Food for Peace Program)
SA:	Security Supporting Assistance
UNDP:	United Nations Development Program

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