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THE CHANGED SETTING FOR
DEVELOPMENT ASSISTANCE AND COOPERATION

Although U.S. Foreign assistance programs got their start in the 1930s with a modest program of aid for Latin America, and were expanded during World War II with a significant Lend-Lease program for Great Britain, they began in earnest in the aftermath of World War II with the Marshall Plan to help Western Europe. The Marshall Plan was an unusual act of national benevolence, with resource transfers at its peak equivalent to over 3 percent of U.S. GNP. This program had strong domestic political leadership and support on the part of the body politic. Moreover, it was a success. Western Europe recovered from its economic and political doldrums, and some forty years later is rapidly moving towards political and economic unification, and to a position of global leadership.

The situation at the beginning of the last decade of the Twentieth Century is dramatically different. The United States now ranks eighteenth out of the eighteen industrialized countries of the West in the share of its GNP (0.01 percent) it provides for foreign economic assistance. Domestic political leaders seldom put foreign aid at or near the top of their political agendas, and the body politic suffers from a serious case of aid-tiredness, no longer believing in the efficacy of foreign aid nor willing to make the sacrifice to provide for it.

In addition, both the political and economic conditions on the international scene have changed dramatically. U.S.

interests on the international scene have changed significantly. The international economy itself has changed dramatically. And the perspectives other countries toward foreign aid have also changed.

It is this changed setting for foreign economic assistance that we discuss in this chapter.

The Need to Develop a Viable Constituency for Development Assistance

The success of the Marshall Plan made it easy for the United States to turn to economic assistance as an important part of its foreign aid program as it gradually realized it was in a "cold war" with the Soviet Union that might extend far into the future. Caught up in what it believed was a battle for the minds of the men and women in the developing countries, application of the same principles pursued with the Marshall Plan seemed like a logical thing to do. After all, the rationale for the Marshall Plan was that poverty and destitution on the European continent would cause the countries of thac continent to slip under the control of the Soviet Union. Economic revitalization kept that from happening, and democratic and liberal traditions were preserved in Western Europe, with the United States benefitting significantly in both economic and political terms.

It was widely believed that a similar program for the developing world would have the same effect. Unfortunately, there was little recognition of the vastness of the challenge in helping to develop the developing countries, nor that the nature of the problem was different. Viewed from the perspective of hindsight, the recovery of Western Europe was easy. The countries of the continent had well-developed institutional arrangements for a modern economy and society, and their stock of human capital in a well-trained and educated population was great. What was devastated as a consequence of the war was its stock of physical capital. With assistance from abroad, this physical capital could be rebuilt quickly, with the added advantage that the new stock of physical capital would have the latest in new technology imbedded in it.

The situation in the developing countries was significantly different. Not only was the population of the developing countries far greater, the relative stock of human capital, now recognized as so critical to economic growth, was sorely deficient. The countries of the so-called "Third World" did not have the institutional arrangements needed for a modern society and economy, and the level of general education (primary and secondary) was quite low. Augmenting the stock of physical capital contributed little to economic growth in such a situation, and raising educational attainment and developing viable institutional arrangements were vast and prolonged tasks, with long gestation periods.

The difficulty and complexity of this task was further exacerbated by the magnitude of the problem and the relatively small amount of resources transferred in light of the size of the task. Translated into per capita terms, foreign economic assistance often amounted to only pennies and dollars, far less than was needed to have a significant impact on per capita incomes. On top of that, the successful transfer of Western medical technology to the developing countries caused their populations to burgeon, thus creating a daunting task in furthering educational attainment while at the same time spreading scarce development resources even further.

By the mid-1960s there was general recognition that development strategies and assistance as applied to the developing countries were not working. The United States was at that time experiencing serious balance of payments problems due to the progressive overvaluation of the dollar. It was also rapidly slipping into the entanglement of the Vietnam War, while simultaneously trying to implement the programs of the Johnson Administration's Great Society. Both the war and the programs of the Great Society drew more and more on the nation's resources and attention. The frustration associated with losing the war caused the United States to turn inward. As a share of its GNP, U.S. foreign economic assistance dwindled, and it rapidly fell behind other developed nations in its relative effort. (See Chapter 4 for detail.)

Unfortunately, few Americans recognize what a small share of this nation's GNP is provided as foreign economic assistance. Nor do they understand that we have learned a lot about economic development and about the sources of economic growth, and that the global landscape is dotted with some very successful development efforts. And most especially, they fail to recognize that a sound economic assistance program can do much to promote this nation's own economic and political interests, and can constitute an investment in its future.

The need now is to develop a viable constituency for a sustained global development effort. That constituency will have to be built on an informed and committed electorate. It will also have to be built on a careful assessment of how development assistance contributes to our own national welfare, and the identification of who benefits and in what way. These issues will be addressed in later parts of the text.

Changing U.S. Political and Economic Interests

U.S. political interests in foreign economic assistance have changed significantly over time. In the aftermath of World War II the intenational economy was characterized by a dollar shortage. With the value of the dollar fixed by the Bretton Woods conventions, providing foreign aid was one means of making resources available to other countries so they could purchase U.S. goods and services. The simultaneous realignments of a number of Western European currencies changed those circumstances and the United States has in the ensuing period injected overvalued dollars into the international system for sustained periods of time, thus taxing the international community to finance its own programs. With the rapid growth in international debt by the United States, and the outlook for a continued decline in the value of the dollar, other countries are now less likely to hold the dollar as a reserve currency as its general attractiveness for this purpose has declined.

A second change in U.S. political and economic interests is a consequence of the relative decline of the United States role in the global economy. In the aftermath of World War II, the U.S. economy accounted for approximately 50 percent of global GNP, with only approximately 6 percent of the world's population. It was the unchallenged scientific and technological leader of the world. It was the only country in the world able to sustain a global presence, militarily and otherwise. Its hegemony was probably as extensive as any single country ever held in recorded history. It pretty well did what it wanted to, economically or politically.

The U.S. position has changed dramatically over time. It now accounts for only about 25 percent of global GNP, with something less than 6 percent of the world's population. Western Germany and Japan have grown to challenge it in economic terms. If the European Common Market is completed in 1992, as planned, the economic/political unit which emerges will challenge the United States in terms of GNP and population, if not in political unity. The United States is no longer the unchallenged scientific and technological leader of the world, and finds itself falling behind in many areas. Although still the only country able to sustain a military, political, and economic presence around the world, it is able to do that only with the acquiesence and aid of other countries. It now must seek political alliances with others, and their financial assistance as well.

In a somewhat different context, the developing countries in the aftermath of World War II were a rather amorphous mass. Many of them were newly created nations, with newly gained political independence. Most of them turned inward both politically and economically, and their economic power was weak.

Some forty years later, many of these countries have experienced substantial economic growth and developed relatively stable domestic political systems. Many of them, such as the Newly Industrialized Countries (the so-called NIC's), have become strong international competitors on the international scene. (These include Hong Kong, Singapore, South Korea, and Taiwan.) Many more developing countries are poised for sustained economic growth. In fact, a significant share of the population of the developing countries may in the next several decades be empowered for the first time in history with economic growth as the Western world has known it.

To summarize, the position of the United States is undergoing rapid change. From a position of overweening economic and political power on the international scene, it is rapidly emerging into a world in which it has strong competitors, and in which it will increasingly have to find its way based on its knowledge of other countries - knowledge of their economic and technological capabilities, their economic, political, and social systems, and their cultures and values - and the strategies it develops based on that knowledge. This has important implications for the kinds of cooperation and collaboration it should seek with other nations, a point we will return to below.

A more recent development is what appears to be the disappearance of the Cold War. The suddenly perceived economic weakness of the Soviet Union, the apparent loss of the Eastern European countries from its domain, and the likelihood that many of the Soviet republics will spin themselves off as separate nations, eliminates the need to wage an ideological struggle for the minds of men and women in the developing countries. These developments will likely change significantly the basis for U.S. relations with countries of the developing world, and with other countries as well.

Finally, the United States has become more fully integrated through trade with the international economy, and in a sense more dependent on the international economy. At one time the United States came about as close to having a self-sustaining, autonomous economy as any country in the world. That no longer is the case. Today, this nation imports over 50 percent of some thirteen raw materials judged to be critical for its manufacturing sector. (See Schuh, 1986.) It now imports over 50 percent of its petroleum. And it imports significant shares of its producer and consumer goods and services which presumably can be produced to advantage elsewhere. The further development of the countries which supply these goods and services is in the interest of the United States, especially if those countries have an inherent comparative advantage in producing them.

The other side of the trade relationship is equally important. The United States needs to earn foreign exchange if it is to pay for the goods and services it needs from abroad. Thus it needs expanding markets for its own goods and services. The greatest potential for those markets is in the developing countries. They will not be realized, however, unless those countries experience increases in their per capita incomes. Thus, in effect, the motivation for U.S. economic cooperation programs is no longer rooted in currying political favor in those countries, but rather in assuring their sound economic growth and development.

Changed Perspectives From the Developing Countries

The developing countries themselves have changed perspectives towards international economic assistance. Although the diversity of these countries and the different stages at which they find themselves on the development ladder makes generalization difficult, there are a number of generalizations which seem to apply.

First, many developing countries have evolved more stable political regimes, have become less defensive about their colonial past, and have developed more confidence in their independence. Latin America is an outstanding example of a region in which authoritarian military regimes have been overturned and democratic governments put in their place. This newly found independence and confidence causes these countries to insist that they be treated as peers and not as poor cousins as in the past. It also makes it more difficult to curry political favor through military assistance programs. And it makes it easier to develop truly collaborative arrangements to attain mutual goals.

Second, many developing countries increasingly recognize the value of strengthening their capacity in science and technology as the basis for their future economic growth and development. The Green Revolution of the miracle rices and wheats have been an object lesson, despite the difficulties many countries have had in sustaining their higher level education and research systems in the face of severe budget difficulties. The value of adequate health care systems, lower level education, adequate nutrition, and family planning are also increasingly recognized.

Finally, many developing countries have now developed their higher education and science and technology systems generally to the point at which U.S. institutions can beneficially collaborate with them on the basis of peers. Faculty exchanges can now be beneficial to both sides. U.S. students can benefit from rigorous educational programs in some developing countries. R & D budgets have grown rapidly in some developing countries, and there is much new knowledge being generated in the developing countries from which the U.S. science and technology establishment can well benefit. Although there is still much institutional development to be done in most developing countries, the agenda in many such countries has shifted from a client/patrao relationship to one in which scientific and technological collaboration is the key to developing sound, longer-term relationships.

The Complementarity Between Development Assistance and Trade

Harry G. Johnson once referred to foreign aid as the "soft" option compared to the "hard" option of international trade.[1] Foreign aid was viewed as the soft option to trade liberalization on the part of the donor countries - a liberalization which would make it possible for the developing countries to earn their foreign exchange through increased exports. It was viewed as the soft option on the part of the recipient countries because it made it possible for them to avoid or delay the economic reforms which would have made it possible for them to be more competitive in the international economy and to reduce deficits in their balance of payments. The reforms needed include more realistic exchange rates, a reduction in the excessive protection of manufacturing sectors, and the elimination of self-imposed barriers to exports generally.

The policy of providing foreign aid as a means of addressing balance of payments deficits should have been abandoned long ago. Such assistance had a certain rationale as long as the fixed-exchange rate, Bretton Woods conventions prevailed. As long as there were proscriptions against exchange rate realignments,

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1 Johnson, Harry G., Economic Policies Toward the Developing Countries, The Brookings Institute, Washington, D.C., 1967.

international financial assistance was needed if prevailing exchange rates were to be sustained.

However, the Bretton Woods fixed exchange rate system for all practical purposes disappeared in 1973 when the United States devalued the dollar for the second time in an 18-month period and announced that henceforth the value of the dollar would be whatever foreign exchange markets said it was worth. Developing countries are no longer bound to keep their exchange rates fixed, and in fact fix them only at their own convenience. In this setting, balance of payments support only delays the day of reckoning for needed exchange rate realignments, and thus in most cases only defers needed reforms in economic policy rather than providing the incentives to make them possible.

In today's world, foreign economic assistance might better be viewed as a complement to international trade. To the extent that it is a response to inefficient or incomplete markets, as in the case of the capital markets to finance human capital, it makes possible a higher rate of economic growth in the recipient country and thus provides the basis for an expansion of demand for imports and an increase in the supply of exports. These are the basis for an expansion in trade generally, and economic assistance thus becomes a complement to international trade. Both the trade and the aid expand economic opportunities by making the economic pie larger.

Another dimension to the exchange rate issue is worth exploring, since flexible exchange rates are an important part of the changed economic setting for development assistance and cooperation. Other things being equal, an increase in the capital flows from the United States to the countries with which it is collaborating results in a fall in the real value of the dollar and a rise in the value of the currency of the country receiving the economic assistance. The fall in the value of the dollar causes the United States to be more competitive in international markets, thus reducing any competitive threats engendered by its collaboration with other countries.

In light of the size of the U.S. foreign aid program in recent years, this effect is likely to be minor on the U.S. side of the relationship. However, on the side of the developing countries, the relative effect can be large. In many African countries, for example, the magnitude of foreign economic assistance flows, when combined from multiple sources, has resulted in significant increases in the value of their currencies. (See Lele,). This significantly reduces their competitive edge in international markets, while at the same time increasing competitive pressures for domestic industries from abroad. The classic "Dutch disease" thus created is a good reason to keep foreign aid flows modest in size.

The International Capital Market as a Means of Financing Conventional Capital

When foreign economic assistance first gained impetus in the aftermath of World War II, there was little that could be described as an international capital market. There was a great deal of uncertainty about the future of the international economy, commercial linkages among nations had been destroyed by the war, and in some cases international communications facilities had also been destroyed. In that setting, it was natural that governments, mainly that of the United States, should step in as a supplier of capital.

That situation has also changed significantly. In the early 1960's, commercial banks in Europe discovered they could relend the dollars on deposit with them and make a profit. Thus emerged what was called a Eurodollar market. That market grew rapidly as experience with it was gained, and eventually the banks began to relend other currencies on deposit with them. This burgeoning capital market thus came to be referred to as the Eurocurrency market.

In 1973, a signal event occurred as the OPEC countries quadrupled petroleum prices over night. Since petroleum was both priced and transacted in U.S. dollars, the international economy was soon awash with a flood of what were described at the time as petrodollars. There was concern by many observers at the time that these dollars be recycled lest the international economy collapse in a Keynesian crisis of inadequate demand. Considerable pressure was put on the commercial banks to relend the petrodollars on deposit with them to keep this from happening.

This supply of loan funds was augmented by a supply of regular loan funds as many central banks, including the U.S. Federal Reserve Bank, pursued highly stimulative monetary policies to avoid a collapse of the international economy. Commercial banks felt a responsibility to recycle this money as well, and thus was born the international debt crisis.

The situation created by the increase in petroleum prices helped to make many developing countries willing borrowers. Higher petroleum prices amounted to a large negative shift in the external terms of trade for petroleum importers. The classic remedy for such a shift is to devalue one's currency as a means of restoring balance in one's external accounts. Borrowing on the international capital market is an alternative policy, however. In general, policy makers - especially those in developing countries - prefer to avoid devaluations if at all possible since they tend to create domestic political difficulties due to the rise in price of critical items for urban consumers. This problem was complicated at the time due to the fact that many observers expected the increase in petroleum prices to be short-lived. In such a setting, borrowing to deal with what might be a short-term problem made a certain amount of economic sense.

Thus was born a marriage of convenience. The banks were under pressure from national governments and international lending agencies to relend their petrodollars and other currencies. The developing countries were avid borrowers as they sought to offset the burgeoning deficits in their balance of payments and to sustain their economic growth. The problem was that the commercial banks, in their rush to keep the money moving, did very little by way of sound appraisal and analysis to determine whether the developing countries would be able to service and eventually repay their loans.

This large monetary stimulus gave rise during the 1970s to the largest and most sustained expansion in the international economy in the post-World War II period. Interest rates were low in nominal terms, and in many cases negative in real terms. National governments, private sector firms, and parastatals borrowed with alacrity and the international capital market expanded rapidly.

This monetary "bubble" all came to an end at the close of 1979 and the beginning of 1980. The value of the U.S. dollar went into a free-fall at the end of 1979 as OPEC again engineered a huge increase in petroleum prices. Paul Volcker, then Chairman of the U.S. Federal Reserve Board, rushed home from Europe to bring about a dramatic change in U.S. monetary policy. The Board decided to stop emitting money to finance the continuing and growing deficit in the budget of the U.S. government. Henceforth, the Treasury would have to borrow from the capital market to pay for the deficit.

Almost over night the developing countries who had borrowed extensively on the international market were hit with a double shock. Almost over night real interest rates rose from low, and in some cases, negative rates to unprecedentedly high rates - on the order of 20 percent. Unfortunately, most of the developing countries had been borrowing on short term, 30 to 60 day capital market instruments. In a very short period of time they were faced with the need to renew their loans at unexpectedly high rates of interest, a factor which significantly increased the burden of servicing their loans.

Their problems did not stop there, however. The huge rise in real interest rates in U.S. capital markets gave rise to an unprecedented rise in the value of the dollar as the United States increased its borrowing from abroad to meet its growing budget deficit. This inflow of capital to the United States pulled capital away from the developing countries. In addition, the rise in the value of the dollar further increased the burden of servicing and repaying the dollars borrowed from abroad. The rise in the value of the dollar meant that the borrowing countries had to give up more in terms of their domestic resources to acquire the dollars needed to service and repay their international debt. In effect, they were faced with a second large negative shift in their external terms of trade.

Under the circumstances, it is little wonder that the developing countries have experienced such serious economic difficulties in the intervening period, nor that they view their external problems as an international debt <u>crisis</u>. Many countries, especially those in Latin America, have experienced sustained and significant declines in their per capita incomes. These problems have been exacerbated by their unwillingness, or political inability, to undertake the economic reforms needed to get their economies back on a sound path to economic recovery.

Under the circumstances it is little wonder that the developing countries have had such difficulties in servicing their international debt. Interest rates have since declined, however, as has the value of the U.S. dollar. Debt service as a share of export earnings has declined by about 50 percent, to around 25 percent, and in a sense the world continues to muddle through in dealing with this severe monetary disturbance.

There are at least two lessons to be learned from this experience. First, the problems of the developing countries in meeting their international obligations were not entirely of their own making. The international commercial banks were especially lax in their standards in lending to the developing countries. The international community put the emphasis in the first instance on recycling rather than adjustment. And although the developing countries should have undertaken economic reform in a more expeditious fashion, the adjustment problems many of them faced were of unprecedented proportions.

Second, an unusual, well-integrated international capital market has emerged on the international scene. Although banks which suffered losses as a consequence of their past errors are less prone to participate actively in that international capital market, it is a market that is open to governments that pursue sound economic policies. Thus, it is a viable means of mobilizing savings from diverse sources and channeling those savings to where the rate of return is highest.

This capital market has the advantage of providing the developing countries with diversified sources of capital. Prior to the emergence of this market, developing countries were literally faced with a choice of external savings limited to accepting foreign aid and thus the potential for political meddling in their country, or equity investments by multinational firms, which had similar political limitations. The new capital market gives them a third choice, which in effect involves much less direct intervention in their economy.

This market also gives the lending or cooperating developed countries new options. They no longer need to be general sources of capital for the developing countries. Instead, they can limit their transfers to those cases in which there are incomplete or inefficient markets. These tend to be the markets for human capital. And it is investment in human capital which can be of greatest benefit to the United States, especially if made in such a way as to be of mutual interest and benefit.

The Changing Role of Multilateral Development Banks

There are four multilateral development banks - The World Bank, and regional banks for Latin America (Interamerican Development Bank), Asia (The Asian Development Bank), and Africa (The African Development Bank). Each of these banks play a unique role. However, there are certain generalities that pertain to issues discussed in this paper.

Consider the World Bank. Most of the capital it lends to the developing countries in mobilized from national and international capital markets. The exception is IDA, which involves concessional loans designed to address the problems of the poor in low-income countries. This money has to be paid back, but no interest is charged on it. (There is a modest service charge.) This money is provided to the World Bank through capital conscriptions from among its member countries.

Two things stand out about the World Bank's lending operation and about its modus operandi. The first is that for over a decade now it has been involved in policy-based lending, with a shift away from project lending which seeks to build the capacity of the recipient country. Policy-based lending comes in two forms, both designed to help induce and facilitate policy reform. The first is called structural adjustment lending, which focuses on general policy reforms for the economy as a whole, such as devaluations of the currency, trade reform, and so on. The second is sectoral adjustment lending, which focuses on particular sectors of the economy.

Approximately 30-35 percent of the World Bank's lending now goes for such lending. However, there is a rather special irony in this shift in lending objectives on the part of the Bank. The International Monetary Fund (the IMF) was created as part of the post-World War II monetary arrangements precisely to provide the short-term lending needed for balance of payments support in a fixed exchange rate system. When the international economy shifted to what is for all practical purposes a flexible exchange rate system, in principle the need for such lending disappeared. That it didn't disappear completely is a reflection only of the failure of all countries to shift to flexible exchange rates.

This issue merits a number of comments. First, a substantial portion of the World Bank's lending now goes for adjustment lending, with the emphasis on inducing policy reforms. That leaves fewer resources to build needed capacity in the developing countries. Second, the payoff from such lending seems to be modest at best. Unfortunately, such lending amounts to little more than balance of payment support. In this sense, it makes it possible for the recipient country to delay the needed reforms, rather than to help it through a transition process. In point of fact, such lending would have a higher payoff if it were used to facilitate labor adjustment within the economy and to build future capacity for growth than for what it is now used. Moreover, policy reform is its own reward. A country should not have to be compensated to do it.

Finally, there are three other features of trends and development in the World Bank that are of interest. First, the Bank has over the years allowed its technical capacity to decline. At one time it had outstanding specialists on tropical agriculture in its employ, as well as outstanding people on infrastructure and other fields. That no longer is the case, and for a variety of reasons that go beyond our interests here. In effect, the Bank is increasingly dominated by economists and generalists. Such specialists have their place in a development bank, but technical specialists are needed as well. In fact, the services of technical specialists are critical inputs into the development process and they are in short supply in the developing countries.

Second, research is receiving less and less attention in the Bank, and the remaining research capacity increasingly focuses on economic issues. A consequence of the last reorganization of the Bank was to focus a larger and larger share of the Bank's analytical capacity on operational issues. This shift in emphasis has occurred at the very time the international economy has become more open and international interdependencies have become increasingly important in designing projects and loan programs. To make effective loans in the changed international economy, more research and more knowledge is needed, not less.

Finally, although much of the rhetoric surrounding the Bank's lending programs focuses on institutional development, the effort is not very effective, to say the least. That is in part because the Bank's institutional development activities focus primarily on sending staff abroad, on very modest scales, and not on developing collaborative arrangements with parallel institutions in the developed countries, or in sending larger numbers of professionals abroad for advanced training. The Bank's activities in this field also lack effectiveness because the Bank simply has not made a commitment to such activities.

The development of viable institutions is critical to obtaining sustained economic development (see next chapter). However, the Bank has over the years concentrated its investments primarily on physical capital, and in recent years has allocated an increasing share of its resources to policy-based lending. Institutional development is a critical need, and U.S. institutions have the capacity to engage in such activities, with the support of this nation's development agency.

The other multilateral development agencies are subject to some of the same criticisms. The difference is that none of them ever were a premier development agency, as has been the World Bank, and thus in some sense have not fallen from a previous high standard. The Interamerican Development Bank, for example, has over the years given higher priority to investments in human capital than has the World Bank. However, it too has neglected institutional development by means of developing collaborative arrangements with institutions in the developed countries.

National Economies that Are Increasingly Open

When foreign economic assistance first received its impetus in the aftermath of World War II, the international economy could best be described as a collection of relatively closed, autonomous economies tied together with a relatively small amount of international trade. Today, the international economy is increasingly well integrated, with international trade having grown at a faster rate throughout the post-World War II period than global GNP, and a huge international capital having emerged to link national economies together in ways they have not been linked in the past. The effect has been to make national economies increasingly open to economic forces from the international economy.

Economies that become increasingly open become increasingly beyond the reach of national economic policy. This leads to two important institutional developments. First, some part of economic policy-making and implementation shift up to the international level and become imbedded in the codes, rules, and disciplines of international institutions such as the General Agreement on Tariffs and Trade. It also becomes increasingly imbedded in systems of economic integration such as the Canada-United States Free Trade Agreement and the EC-92.

Second, some part of policy-making and implementation shift downward to the state and local levels. In the process of shifting downward, moreover, economic policy changes character. It shifts away from an emphasis on product and commodity markets, and focuses instead on incomes policies and on resource issues. Such shifts have become increasingly important around the world, not the least in the United States where state governments have been growing at a rapid pace over the past decade.

These shifts in where economic policy is made and implemented increases the demand for new institutional arrangements. Developing countries, for example, now need a capacity to understand international institutional arrangements, and an analytical capacity to understand the issues at this level if sound "local" policy is to be devised and implemented. At the same time, they need localized institutional arrangements and analytical capacity if they are to develop sound policies at the state and local level.

To summarize, in the past, developing countries needed national institutional arrangements to develop national economic policies. Development agencies thus attempted to help them to develop the capacity to attain this end. In today's world, however, developing countries need assistance in developing the capacity to understand the international economy, and in developing state and local research and analytical capacities to help them decentralize their policy-making and implementation.

Conclusions

The setting in which international economic assistance is implemented has changed dramatically since the period in which the provision of such assistance became an important part of this nation's foreign policy. Because of these changes, the amount of foreign aid needed has changed, and the use to which it should be put has also changed. U.S. interests in foreign aid have changed, and perhaps should have changed more than it has. The same applies to the developing countries. Thus, not only does a new political constituency need to be identified for international economic cooperation, but a sound intellectual rationale for such cooperation needs to be articulated. The remainder of this report is oriented towards that end.