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A Review of "Accelerating Development in the Poorest Countries"

by

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Accelerating Development in the Poorest Countries
by Paul Streeten

Overview

This paper contains some useful ideas about development in the poorest countries. The author is strong on facts, although his views are sometimes questionable. Streeten sometimes tends to institutional solutions and government intervention, though he is certainly no ideologue. Still, it remains an article worth reading: the paper touches on many issues and is full of many interesting tidbits and observations. His sections on aid administration and policies for LLDC's are the strongest of the paper. In the interests of economy, this review will consider only the major issues.

Adaptation of Policies for LLDC's

Streeten begins with a short list of mental changes that must be made when thinking about development of the poorest countries. First, it is a mistake to measure development by GDP growth rates. He suggests that at extremely low income levels, growth of income per head is driven by income level per head. Policies should aim to establish minimum living standards: a first principle of development must be a relatively healthy populous. It is also a mistake to focus on growth rates because the economies in question are agricultural, for which low growth rates prevail.

Streeten questions the notion that success will come through outward-looking trade policies, instead of inward-looking policies. He argues that inward-looking countries are generally low-income countries, and suggests that slow growth may be a function of low income as much as inward-orientation. Streeten's point is not convincing, although it is refreshing to have someone question the new focus on outward-looking growth. A more convincing point is that any country must trade according to comparative advantage, and an export-orientation may run roughshod over this just as much as import-substitution.

The author believes there is a larger role for the public sector in the poorest countries, making the argument that if the government does not undertake certain activities, they will not get done. Unfortunately he is not more specific. If his suggestion is that certain industries would not exist without government presence, we might question whether the industries should exist at all. If his point is that government must play a role in laying infrastructure, his point is more defensible.

His last point is his best: underdevelopment will not be erased by throwing money at the problem. Constraints to development are ultimately supply-side (human attitudes, skills, motivation).

Aid Administration

Streeten follows with an interesting conception of aid. He suggests that we should think of aid as a transitional support that will provide adjustment assistance to "rigid and inflexible" economies. His notion is a little fuzzy: it is unclear that the economies are rigid and inflexible -- and clearer that there are often political constraints (vested interests, urban vs. rural power, foreign ownership) to development. Streeten implicitly recognizes this when he hammers out his idea of aid. Apart from providing project funding, aid can be used to reduce the social costs (both to vulnerable groups and to powerful vested interests) of adjusting to sounder economic policies.

Streeten has some useful suggestions for improving aid administration. First, he argues that multilateral aid institutions are often insensitive to the social and political troubles of their clients. He advocates greater decentralization, and points to USAID and the Commonwealth Development Corporation as two models. Second, he argues that aid should be carved up by regional portfolios, to avoid country policies that conflict with one another. Third, he advocates greater coordination among donors (though he doesn't elaborate on how this will be achieved).

Fourth, he argues that aid organizations should <u>manage</u> projects, instead of providing money and walking away. Above all, the poorest LDC's need technical assistance (while Latin America needs trade, and South Asia needs capital). Again, he holds up the example of the Commonweatlth Development Corporation, and revives the notion of a "paunch corps" -- a Peace Corps for executives. Streeten recognizes that all of this may be politically objectionable because it smacks of paternalism. He addresses this issue, though it remains unclear how this problem can be evaded.

<u>Food Aid</u>

Streeten has some ideas about food aid that are not very persuasive. He tackles various objections to food aid, the most important being that food aid reduces incentives to production by depressing domestic prices, and that it impedes policy reform. He suggests that producers can be compensated by a share of the proceeds from the sale of food aid. Moreover, arguments about producer incentives have become less important, given that many of the poorest LDC's are net importers of food. He also argues that the argument that food aid impedes policy reform could be applied to aid in every sector.

These are curious points. High import levels and low producer incentives are partly results of government policies that have discriminated against agriculture. If that is the root of the problem, is that not the root of the solution? There is something preverse about righting discriminatory policies with handouts generated by the sale of food aid (and is Streeten is aware of the political odds against this). His strongest point is that there are historical examples in which food aid did not reduce producer incentives (Europe under the Marshall Plan, South Korea, Israel, India).

Primary Exports

Streeten advocates the use of price-stabilizing schemes for primary exports. However, his reasons are macroeconomic instead of distributional. For economies dependent upon primary exports, the larger economic climate (inflation in particular) can be easily affected by price swings. He suggests the use of buffer stocks as a remedy. It is unclear that this will work in some markets, such as minerals, for which recessions can be years long. Moreover, this is not even an option for many agricultural products, which are highly perishable (grains excluded).

Technology

Streeten has something to say about the problem of technology transfers. The poorest countries face a choice between maximizing the flow of technology across their borders, and limiting the flow to those technologies simple enough that they can be transferred. He takes the view that technology beyond the reach of the local economy only increases dependence. The solution, he suggests, would be the establishment of research institutes in advanced countries concerned primarily with appropriate technologies, encouragement of exchanges among developing countries, and the creation of a bank that would pool international information. This may be a worthy idea, but we should credit LDC's with the ability to make their own decisions about what the appropriate mix of technologies should be. If their economic policies have sometimes been imprudent, perhaps this is increasingly the work of politcal constraints in LDC's, rather than economic amateurism.

FDI

Streeten's final section asks how we can make foreign direct investment work better in the poorest countries. He first points out that the distinction between public and private sector investment in LDC's is often a false one: fdi must often be accompanied by public investment in infrastructure. Second, he suggests that fdi can be made more "socially responsible", by which he means that it should better involve local suppliers, contractors, etc. He uses the example of the Kulai Oil Palm project in Malaysia, or the Kenya Tea Development Authority.

He goes on to detail a model for fdi that makes it more attractive to LDC's. The most important idea is for country and company to agree on a joint venture that will eventually (say after seven years) be completely bought by the home country. Streeten's model would certainly be attractive to many LDC's, so attractive that only companies expecting high rates of return might participate.

Total Relationship

Streeten's final point is a good one, namely that aid is only part of relationship between the first and third worlds. He suggests that industrialized countries can do as much for LDC's through trade and macro policy as they can with aid.

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Accelerating Development in the Poorest Countries

Paul Streeten

The case for cooperation

It is now evident that few of the early generalizations about "the Third World" or "development", and the recommendations based on them, can withstand close analysis and scrutiny, and that different principles apply to different regions at different times under different circumstances. This paper is devoted to exploring US policy toward the poorest countries. These are in South Asia, in Sub-Saharan Africa and a few in the Caribbean and Latin America. Even for this group of low-income countries few generalizations are possible, and policies have to be tailored to the special needs and opportunities of different countries and regions.

Although everyone now accepts the need for differentiation, there has also been an opposite tendency at work. We have learned that some of the problems of the developing countries are shared by all, and features that were thought initially to be applicable only to them, have been found to apply also to the advanced countries. While analysis and policy have therefore become more differentiated, there has also been a reassertion of the unity of the subject, particularly if we remember that the now advanced countries once were also underdeveloped and poor, that some regions inside the advanced countries suffer similar problems to those of low-income countries, and that some very poor countries have achieved quite high incomes within a few decades.

In differentiating between the middle income developing countries and the low income countries, the first difference to be noted, at least for some of the poorest countries, is the basis of the case for US cooperation and assistance. It is nowadays fashionable to base the case for international cooperation, including aid, on national self-interest. These countries, it is said, constitute important markets for our exports, generate many jobs in the USA, and supply us with important raw materials, lower cost imports, and opportunities for renumerative private investment. On the political plane it is said that development makes for democracy and peace, and that aid helps us win friends, allies and strategic support. Whatever the merit of these arguments, it is fairly clear that they would have to be radically modified for the lowest income countries of Africa. If development aid were a form of US export sales promotion, or US employment program, we would concentrate it on the highest income developing countries which would be our best markets and employment generators. It is true that newly industrializing countries, such as South Korea and Taiwan, were very poor only 30 years ago (Taiwan in 1950 enjoyed incomes of $100 per head, which are now $2,200 and it is America's seventh largest trading partner), and some of the poor countries today may be quite well off in thirty years time. But even 30 years is quite a long time if we are interested in earning foreign exchange or creating jobs now.

There can, of course, be a national self-interest in developing some of the poorest countries that arises from causes other than US exports and US employment. Some of the low income countries provide very important raw material imports to the USA; tungsten, tin, bauxite, manganese, cobalt, tin are metals of value to the US economy of which the developing countries supply more than half. All natural rubber and cocoa are imported from developing countries. US food aid to very low income countries can provide a useful disposal of U.S. agricultural surpluses. Some of these countries may have strategic importance. But the principal argument for cooperating with the poorest countries is largely moral or humanitarian, or, if self-interested, based on a long term view that a prosperous world is a better world for the USA. Enlightened long-term national self-interest here may largely coincide with the humanitarian case: every human being born into this world should be given the opportunity to develop his or her potential, and this makes for a better (as well as more productive) world community than one in which human talent is wasted and human misery persists.

The case for aid to and cooperation with India and other countries in the sub-contintent is somewhat different. By whatever criteria one chooses, India is still one of the poorest countries in the world. Its development potential is high. It has an efficient administration, a high level of education and skills, and a reserve of entrepreneurship. It is now the world's seventh largest industrial power and a large potential future market. Its plans and policies are well conceived, and it has achieved high savings rates. There can be no doubt that it has considerable absorptive capacity. It is the world's largest democracy and has strategic importance to the United States. Whether one's criterion is strategic, the encouragement of democratic government. the promotion of self-help, good performance, the relief of the poor, meeting basic needs, or the activation of development potential, India should qualify for massive concessional aid. To drive India into the commercial capital markets may amount to preparing the ground for a Latin American-type debt crisis in 10-15 years' time.

It has now been well established that agricultural growth in the developing countries does not reduce, but, on the contrary, increases agricultural exports from the USA. This is so for three reasons. First, because the propensity to spend on food in developing countries is higher than additional food production; second, because the switch to meat as people's incomes grow raises the demand for feedstuffs for cattle; and third, because the growth of non-agricultural incomes, to which agricultural growth contributes and which also occurs autonomously, gives rise to a higher demand for imported food. American farmers therefore need not be afraid that helping poor countries to develop their agriculture will undermine their earning opportunities. But these opportunities apply largely to middle income countries, where the agricultural revolution has already occurred. It is mentioned here only to show that there is no need to fear that encouraging the poorest countries to develop their agriculture could in the future damage American farmers.

Adaptation of policies

Not only is the case for cooperation and aid different for the poorest countries, but the prescriptions for policy are also in some respects different. Some of the tenets of current conventional wisdom about development policy have to be qualified for the poorest countries. It is important to bear these qualifications in mind not only for the policy makers in the developing countries, but also for the USA when it is imposing policy conditions on aid loans.

First, economic growth as measured by rising national income or national income per head, sometimes taken as a principal performance criterion, is not the top priority for poor countries. (Some would say it should not be a top priority for any country.) If we accept the metaphor of the "take-off into self-sustained growth", the task for the poorest countries is to lay the runway. Laying the institutional and human foundations for future growth is not immediately reflected in high growth figures. A curve relating growth of income per head to levels of income per head would show the shape of an elongated S. At both very low and very high levels growth is relatively slow, while middle income countries register higher growth rates. The indicators to look for in monitoring performance are then not so much growth of income per head as increases in life expectancy, reductions in mortality, especially infant mortality, rises in literacy, etc. Massive human investment in the early stages of development can pay high growth dividends later, as Japan, Israel, South Korea and Taiwan have shown. The USA can contribute to this foundation laying. A high priority should be attached to projects and programs for the social sectors, and within these to projects and programs specifically tailored to poor people. Not only will these raise the welfare of particularly deprived groups, but they will also contribute to raising production and productivity by improving human capital. Conventional infrastructure projects may also be indicated in some countries, though attention has to be paid to the correct type: small feeder roads from farms rather than four-lane highways; small local storage facilities, rather than mammoth silos.

The low income countries, particularly in Africa today, but also India in the past are (and were) often berated for their low growth rates. But in addition to the need to lay the foundation, which makes future growth possible, poor countries have a large agricultural sector, and agricultural growth rarely exceeds 3-4% per year. When 80 per cent of the labor force is in agriculture, and population grows by 2-3%, aggregate growth of income per head cannot be very rapid, even if industrial growth is very high.

Secondly, in very poor countries, lacking in technological, entrepreneurial, managerial and administrative skills, the common prescription of minimal state activity, even if it were correct for middle-income countries, does not apply. Even though the state performs many activities badly, if there is no one else to carry them out, this is the only option. Hence the role of government intervention in very poor countries is inevitably different from that in higher income countries. Clearly, even in low-income countries state intervention should be efficient and, in view of the scarcity of administrative resources, concentrated on priority areas. But to advocate that the state should withdraw from most activities would mean either that they would not get done at all, or that they would be taken over by alien minorities organized in private monopolies.

Even in countries where the public sector should be shrunk, it is very important to maintain incentives for public servants to give their best. The present mood of state minimalism is in danger of leading to actions that permit the best people to leave the public service so that only the dead wood remains, and to underpay them, so that they become demoralized and open to corruption.

Thirdly, the common prescription of "outward-looking" trade policies has to be qualified. In presentations common today (such as the World Bank's <u>World Development Report</u>, 1987), outward-looking trade strategies are cited as the cause of good growth performance, and inward-looking policies made responsible for slow growth. This argument has been criticized on several grounds. First, trade strategy and economic performance may both be due to a third factor; second, correlation does not indicate causality; and third, causality may run from performance to trade policy.[1] The relationship is different for periods of world growth from periods of

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1 See Hans Singer, "The World Development Report 1987 on the Blessings of 'Outward Orientation': A Necessary Correction" <u>World Development</u>, forthcoming.

stagnation. Moreover, a phase of inward orientation may be a necessary condition for a subsequent successful phase of outward-orientation.

But a fundamental flaw in the Report's statistical association between outward- and inward-orientation on the one hand, and economic performance on the other is that they ignore the fact that the inward-looking and slowly growing countries are also the low-income countries. It could therefore be that their slow growth is the result of their low incomes rather than of their inward-looking trade policies. South Korea has clearly had a better growth record than Zambia. But surely this cannot wholly or even largely be due to South Korea's outward-looking trade strategy, if indeed it has been outward oriented. The low income countries of Africa are not so much handicapped by the inward-looking character of their trade policies, as by their low income levels, their lack of skills and infrastructure, and the instability of their import volume.[2] It could, of course be argued that the instability of imports is itself a function of the absence of diversified exports and foreign exchange reserves, themselves the result of inward-looking trade policies. But this would be ignoring again the inevitably low levels of adaptability and flexibility in very low income countries.

Fourthly, the widespread view that development can be speeded up by providing more money ("throwing money at the problem" as the current phrase

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2 See Gerald K. Helleiner "Outward Orientation, Import Instability and African Economic Growth: an Empirical Investigation" in Theory and Reality in Develoment ed. by Sanjaya Lalll and Frances Stewart, Macmillan, 1986, pp 139-153, and Hans Singer, "The World Development Report 1987 on the Blessings of 'Outward Orientation': a Necessary Correction" World Development. Also Michael Michaeli, "Exports and Growth: An Empirical Investigation", Journal of Development Economics, vol 4 No. 1 March 1977 and David Wheeler, "Sources of Stagnation in Sub-Saharan Africa", World Development, vol 12 No 1, January 1984. See also R.M. Kavoussi, "International Trade and Economic Development: the Recent Experience of Developing Countries", The Journal of Developing Areas, April 1985, pp. 379-392.

goes) has to be modified for the poorest countries. While finance can, of course, often help, the crucial bottlenecks are human attitudes and aptitudes, skills and motivation, which are essential to prevent the money from being wasted.

Fifthly, the current obsession with "getting the prices right" has its uses in Africa, but it is important to remember that the right prices work only in conjunction with non-price measures, many of which are in the public domain. Without roads the larger agricultural crops, stimulated by higher prices, cannot be brought to the market. Without research into appropriate seeds the supply elasticity of agricultural crops is liable to be very slow. Without credit institutions, farmers cannot get the finance to buy the inputs. Without irrigation, arid land cannot produce much more. In some situations, getting prices right without these non-price measures can be either ineffective or counterproductive.

Sixthly, there is an important difference in the way of dealing with the debt problem. Debt forgiveness for Sub-Saharan Africa has three merits which do not apply to Latin America or other parts of the world with higher incomes.

First, the debts are much smaller in absolute terms and write-off presents no danger to the financial and banking system.

Second, debts are largely owed to governments rather than private banks, and therefore forgiveness presents no threat to the banking system or to the debtor's creditworthiness, which is low anyway.

Third, for these and similar reasons, forgiveness is not likely to be regarded as a precedent by others, who would not demand similar treatment. For these three reasons, debt forgiveness should be a high priority for the lowest income countries.

The World Bank and the Fund have now come to see this difference and are advocating, for the poorest and weakest countries (such as Zambia, Bolivia, Costa Rica), forgiveness of debt as a precondition for their resumption of economic growth. For the richer countries (Mexico, Brazil, South Korea) additional lending and increased indebtedness can be a way of raising export earnings, reducing import requirements, and attracting additional capital. But for the poorest countries solutions that increase indebtedness will not work. Of course, multilateral action is necessary or else one creditor's forgiveness just goes to pay off less lenient creditors instead of helping the country. But both Mr. Conable and Mr. Camdessus have made attempts in this direction.

Development aid

In the past aid used to be considered as a gap-filling activity. Aid was thought to supplement either the domestic savings or the foreign exchange earnings of low income countries, and accordingly to fill the resource gap or the foreign exchange gap. Today this way of looking at aid has been replaced by a different view. External resources, properly used, add flexibility and adaptability to otherwise rigid and inflexible economies. It makes it possible to bring about the many adjustments that development calls for less abruptly, and therefore at lower social costs. External resources can also be used to bring about these adaptations with less damage to particularly vulnerable groups (the poor, the unemployed, children, women) and to productive investment, the source of future growth. But since aid can also be used to postpone or evade these adjustments, it is important to ensure that it be used efficiently.

At the same time it has often been said that poor countries lack "absorptive capacity". By this was meant their limited capacity to prepare, design, execute and maintain aid projects, and to formulate and implement development plans. But on closer analysis the notion of "absorptive capacity" dissolves into the question of the composition of aid, especially between (a) technical assistance, including assistance in project preparation, and financial aid, (b) project and program aid, and (c) aid covering capital costs and recurrent costs. Aid donors can and should give technical assistance in project design, as well as in the execution, maintenance and (as will be argued below) management of these projects.

Adjustment and adaptation are of the very essence of development: from subsistence to production for the market, from rural to urban, from agriculture to industry, from self-sufficiency to foreign trade, from exports of primary products to non-traditional manufactured goods, etc. But more recently a particular type of adjustment has been discussed to which aid can contribute, viz. adjustment from a set of bad policies to better policies: from capital-intensive to labor-intensive development; from high-cost, capital-intensive import substitution to labour-intensive exports, from excessive emphasis on industry behind protection to agriculture both for export and domestic consumption. One may add adjustment to economic and social reforms, such as a land reform, a tax reform or an administrative reform. In such situations aid can be used both to tide a country over transitional economic difficulties and as compensation to overcome vested interests.

Such adaptability can be achieved by assisting in the development of four resources: management, institutions, technology and human resources. These are discussed in separate sections. This section is concerned with

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improving methods of aid administration, and of improving the impact of finance on development.

This can be done in ways which are not often discussed. I shall concentrate on relatively unexplored ways of raising the effectiveness of aid. First, when macro-policy conditions are attached to aid loans, this should be done in ways which are socially and politically sensitive to local conditions. Externally imposed policy conditions can be counterproductive if they encourage the mobilization of opposition groups. One way of overcoming this difficulty is to have a decentralized aid administration. The local aid representatives are then in daily contact with the policy makers and understand their concerns and constraints, while keeping a low profile. Foreign missions sent in by plane, which stay for a brief period and think they know all the answers, can be ineffective or counterproductive. U.S. A.I.D. is already considerably more decentralized than, say, the World Bank or the International Monetary Fund. But further strengthening in this direction can yield high returns in terms of the acceptability and soundness of policy proposals and the effectiveness of the policy dialogue. The British Commonwealth Development Corporation began to be an effective aid agency when Lord Reith decentralized the staff to regional offices from which project proposals came to headquarters in London.

The decentralized local offices with long-term staff should not be on a national basis, except for very large countries, but on a transnational, regional or sub-regional basis: West Africa, East Africa, the Caribbean, etc. Only in this way can the malinvestment be avoided in which one country diversifies into the export surpluses of another, and vice versa, and regional cooperation be encouraged.

A second reform points to the need not just to lend money, sometimes combined with technical assistance, but also to manage the projects, with a direct stake in their success. Now aid agencies cease to take an interest in a project just when it becomes most important for them to do so. This applies partly to the way in which capital costs and often initial recurrent costs only are covered, but when the project has to be continued and sustained, the foreign agency withdraws. But it also and mainly applies to the continued supervision and management, after the project has been put in place. The purpose of continuing management would not be to maximize profits (as in direct private foreign investment), but to maximize development. This means training local counterparts, to whose management the project is gradually turned over. In Africa the problem is above all a shortage of managerial talent and entrepreneurial and technical skills. Technical assistance, advisors and experts, often hired for short periods without home base backing and without career prospects, are no substitute for direct management and responsibility. Here again, the Commonwealth Development Corporation is a model worth studying. It is unique in that it is the only development agency that combines the task of lending with initial responsibility to manage its projects and enterprises efficiently, covering costs, and handing over to local people both ownership and management, when they are ready.

The development of what in Britain was called the Paunch Corps and in America the International Executive Service Corps was initiated by David Rockefeller and William Paley. It is an imaginative beginning. Retired business executives make their services available to manage enterprises in Africa, and to train local counterparts. The proposal here is that members of this Corps should not act just as advisors, but be responsible for the efficient running of their projects.

A principal objection voiced against the proposal that US management should be involved is that it is neocolonialist and politically unacceptable. To meet this objection a high degree of sensitivity to local social, political and cultural conditions is needed. It might also help if the corps of managers is recruited not only from one group of nationals, but is given a genuine international flavor. Their style of living should also not be too different from that of their future counterparts. In order to work out an acceptable salary structure without creating excessive differences between foreign executives and locals, a part of the remuneration could accrue in the home country of the foreign manager, while they were living modestly in the developing country. Retired executives might also be willing to provide their services for less than their market value in the U.S.A. This proposal is intended only for some of the low-income countries of Sub-Saharan Africa and not for the Indian subcontinent, which is already quite rich in managerial and entrepreneurial talent.

There are four other ways in which the quality and effectiveness of aid can be improved. First, project aid still has a bias for capital and foreign exchange expenditure, and against operating, recurrent and local costs. A correction of this bias could help in making a given amount of aid more effective. Second, the present way of annual budgetary allocations interferes with the long-term reliability of expectations of a continuing flow of aid funds. Commitments should be made over longer periods, so that they can be reliably fitted into the development plans and strategies of recipient countries. Third, there is the much discussed point of the need for coordination of different donors' efforts. In spite of some successes by consortia and consultive groups, the present uncoordinated system puts a heavy burden on the frail administrative base of poor recipients. Fourth, donors are often more interested in quick and visible successes than in helping to lay the institutional and educational foundations for future development, whose results are slow.

It would be a gross oversimplification, but with a kernel of truth, to say that South Asia needs capital, Latin America needs trade, and Africa needs technical assistance. This section has argued that technical assistance, as dispensed now, is too short-term, without a proper career structure, and with inadequate home base backing. The result is that it does not attract the best people. Dudley Seers once wrote an article entitled "Why Visiting Economists Fail". The companion piece to this remains to be written: "Why Failed Economists Visit". To overcome these shortcomings, better ways of strengthening the institutional and human basis of poor economies have to be found.

Who should get aid? A cynic might say there are the needy and the speedy. The needy don't know how to use the aid; they lack "absorptive capacity". The speedy do well without aid and don't need it. Therefore: no aid to anybody. The proper recipients are, of course, the greatest potential improvers: those to whom the aid makes the greatest difference in the current value of the future discounted flow of welfare, properly weighted for poverty, discounted for time, and, for a bilateral donor, also weighted for political distance. In practice this would mean supporting governments that are intent on embarking on a sensible set of policies with respect to economic growth and poverty eradication. Given sensible policies, the choice of aid projects becomes much less important. Even the best projects can be ruined by bad macroeconomic policies, and even quite

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unimaginative projects can be very useful if they free domestic funds for more imaginative ones. But it must be remembered that not only projects are fungible, but policies, too, are fungible. It is of no use to focus on single issues such as devaluation or the budget deficit. Nor is it sensible to impose the "correct" policies as conditions for aid. They should emerge from a sensitive dialogue between people fully aquainted with each other's problems.

Vulnerable groups

In our preoccupation with abstractions and statistics, we sometimes forget that development is for people: to give them the opportunity to develop their full potential. All too often in the process of development vulnerable groups shoulder the heaviest burden. Thus in the transition from subsistence-oriented agriculture to commercial agriculture, women and children are sometimes hardest hit. In the transition from a traditional society, in which the extended family takes care of its unfortunate members, to a market society, in which the community has not yet taken on responsibility for the victims of the market, the fate of these victims can be cruel. The protection of these groups is needed mainly for their wellbeing, but also as a way of protecting the environment, of raising the productivity of the present and the future labor force, and of reducing population growth. The emphasis in the literature is laid on the productive and reproductive aspects of meeting basic needs, but it should never be forgotten that these are also ends in themselves.

The contribution of US policy here can be the improvement of cooking facilities, so that women do not have to spend hours collecting firewood and denuding the thinning forests; the construction of water wells nearer homes, so that they do not spend long hours fetching water and have more time to care for their children, to contribute to production, and to participate in the political process; and the strengthening of the educational facilities for girls and adult women, which has results not only in better home care, but also in reducing desired family size and improving the impact of schooling by reducing drop-out rates. Some of these issues come down to political representation. In some African countries women are not represented on village councils and their needs are therefore not heard. Deforestation and desertification are as much the result of lack of empowerment of women as of ignorance or poverty.

But the best support for projects can be futile if the macro-policies are wrong. A resumption of higher growth and demand for imports, a reduction of protectionist barriers, and a lowering of interest rates on the debt would repair the damage that has been done to women, children and the jobless in the poor countries. A change in the thrust of technology, which has been biased against women's activities in agriculture, would also help. Support for education which aims at producing an adaptable, flexible labour force, not the educated unemployed with excessive aspirations for employment, should be high on the agenda.

Food Aid

Food aid, properly administered, can contribute to development and simultaneously draw on US farmers' support. In the low-income countries food aid can contribute to food security, and it can also play a part in programs with objectives other than food security, such as employment generation through rural public works, or programs of improving nutrition.

There are at least seven criticisms that have been made of food aid, other than emergency famine relief:

First, it reduces the pressure on recipient countries to carry out policy reforms, especially with respect to producer incentives and nutritional objectives.

Second, it tends to depress domestic farm prices, to discourage domestic agricultural production and to reduce the spread of production-increasing agricultural technology.

Third, it is unreliable, because it depends on donors' surpluses. When needs are greatest, i.e. when prices are high, it tends to dry up. Thus in the plentiful year 1970 annual food aid exceeded 12.5 million tons, whereas in the food crisis of 1973-74, when the price of wheat rose by 50 per cent, annual shipments fell to below 6 million tons. Not only the timing but also the country distribution serves the political, economic and military interests of donor countries. Thus in 1982 and 1983 Eygpt received 18 per cent of the food aid distributed by the Food Aid Convention. Moreover, since donors make their allocations in terms of money, higher prices buy a smaller amount of grain.

Fourth, if administered through state agencies, it is said to reinforce state hegemony over people and does not reach the poor.

Fifth, it promotes an undesirable shift in consumption patterns away from staples and towards wheat and wheat flour.

Sixth, it disrupts international commercial channels.

Seventh, it leads to unfair burden sharing between food importing and food exporting donors, if the price of food is overvalued.

The principal objection, that it discourages domestic agriculture by depressing prices, can be met by using the counterpart funds from the sale of the food aid at market-clearing prices to make deficiency payments to the farmers who would otherwise be injured, so that supply prices are restored to the level they would be without the food aid. (Even food distributed free, say in schools, frees budgetary revenue if the government would otherwise have paid for it.) In this way the amount by which expenditure on food aid reduces demand for domestic food is channelled back to the farmers and incentives are fully restored. The reason why this obvious solution has not been adopted more frequently is the budgetary/political constraint. Financially straitened governments normally find other uses for the collected revenue of greater importance to them and cannot, or do not wish to, collect additional revenue.

Food aid can also be used to finance additional food consumed by construction workers on infrastructure projects for agriculture. Or food aid can be linked with other forms of agricultural assistance to avoid neglect of agriculture. Or additionality of demand can be ensured by distributing the food or its money equivalent to the poorest households who could otherwise not afford it. But the importance of the charge has been greatly reduced, if not entirely eliminated, by the fact that many developing countries have become substantial food importers. (Only in low-income African countries is food aid increasing as a proportion of food imports.) In such a situation the traditional roles of food aid and financial aid are reversed. Food aid, in so far as it replaces commercial purchases, becomes fully convertible foreign exchange, whereas financial aid often remains tied to procurement, commodities or projects. It has, however, been argued that the free foreign exchange made available to governments presents an obstacle to fundamental reforms, such as devaluation of the exchange rate, or investment and reforms in agriculture, which would raise food production. But this is not an argument against food aid, but against all forms of intergovernmental aid. It can be used either to support or to delay reforms.

Food aid can be used either as balance of payments support or as budgetary support. The two extreme cases are, first, where the food aid is wholly additional to commercial purchases and is sold by the government in open markets at market clearing prices, yielding government revenue in the form of counterpart funds of the maximum amount; or, second, where the food aid wholly replaces commercial imports and the foreign exchange saved is used to buy other imports, or more food, or to repay debt.

Historically, there are many instances of food aid that did not harm domestic food production. Forty per cent of Marshall Aid consisted of food aid, yet European food production flourished, excessively. Similarly, South Korea, Israel and India received large amounts of food aid, without apparent long-term harm to their agriculture. It can be shown both analytically and historically that food aid can be given in ways that encourage domestic agriculture.

The charge of disruption of commercial sales is greatly reduced by the shrinking and now small role of food aid in total world food trade. If food aid wholly replaces commercial sales by the donor (the government pays the farmers what they otherwise would have earned) no disrupting effects on sales by other countries are suffered. Ensuring additionality, e.g. by linking it with job creation for poor people who spend a large portion of their income on food, also reduces the damage to commercial sales.

Additionality of supply is also important in order to meet the charge that advanced countries that are commercial food importers are faced with higher prices than if, in the absence of food aid, the food had to be sold through commercial channels, lowering prices. The valuation of the food aid has to be done in such a manner as to ensure fair burden sharing between food surplus donor countries and food importing donor countries.

Another charge against food aid is that tastes depend, to some extent, on relative prices and food availabilities (and are not given exogenously, as is often assumed in economic analysis). A prolonged policy of finer grain imports changes tastes away from domestically produced food stuffs and, it is alleged, increases dependency on foreign supplies. The situation has been described as analogous to drug addiction, countries becoming 'hooked' on grain. It should, however, be remembered that these changes in tastes have many causes, connected with development and urbanization, with commercial import policies and with the growing value of time as incomes grow, and that food aid is only one, possibly small, contributory cause.

One of the key questions in improving the role of food aid is, again, the administrative capacity and the avoidance of corruption. What has been said above about the role of management, both in the private and in the public sector, also applies here.

The volume of food aid has been greatly reduced in the last twenty years. Food aid has, however, increased since 1975. In the sixties it had been as high as 16-17 million tonnes in some years. In 1973-4 the cereal tonnage had fallen to 5.5 million tonnes. In 1976-7 it was 9.0 million tonnes and in 1984-5 had risen to 10.4 million tonnes. The 1985-6 figure is higher because of emergency aid to sub-Saharan Africa. There has been an increasing proportion of non-cereal food aid, not covered by these figures, especially EEC aid in dairy products. The aid component of food aid has also increased and more has gone to the poorest countries. Africa has benefited at the expense of Asia, and within south Asia Bangladesh at the expense of India, and project and emergency aid have replaced bilateral programme aid.

At the same time, so called subsistence crops such as sorghum, millet, yams, cassava and bananas could be traded in local and even national markets, if they were not discriminated against. Low prices of subsidized grain, the import of which is encouraged by overvalued exchange rates, or which is supplied by food aid, discourage the production of these 'poor man's crops' for the market. Although devaluation would encourage the production of export crops, the demand for the subsistence crops would also rise and would constitute an incentive to produce more. The precise amount would depend on the elasticities of substitution in supply and demand. Relatively little research is done on these crops, although there are some exceptions, such as sorghum in Maharshtra and the Sudan, and maize in Zimbabwe. The International Institute for Tropical Agriculture in Ibadan (Nigeria), which is part of the system set up by the Consultative Group for International Agricultural Research, specializes in research on roots and tubers. But more could be done for these crops, especially millet and sorghum. Even where research on food crops has been successful, African countries lack the indigenous research capacity to adopt and adapt the results of this research, so that much expenditure on research has low yields.

To give greater encouragement to research on subsistence crops would have the advantage that they can be grown on marginal land, do not require a sophisticated technology or complex skills, are ecologically benign, and have frequently great nutritional value. They can also be used to supplement the more preferred cereals when these are in short supply, through additions to wheat flour or maize meal. But even if research in this area were to yield good returns there are limits to what can be expected. These crops, particularly roots and tubers, are bulky and expensive to transport. Storing and processing them is costly and often capital-intensive.

Primary exports

The low income countries tend to be largely primary exporters of minerals and agricultural products. Concentration on one or a few of these commodities, and often also by their destination, tends to be high. As a result, the countries are vulnerable to price fluctuations and technical innovations that replace these products.

The commodity price stabilization schemes propagated by UNCTAD and others have not succeeded in getting accepted. The reasons are partly political, but partly a lack of a convincing analytical justification. In the past, the case has been made out on grounds of stabilizing incomes of producers or consumers. This case has been largely refuted. But the case is much stronger if it is made on grounds of macro-policy. Primary product exporter from developing countries show two characteristics. First, primary producers are largely price-takers, whereas the producers of manufactured products are price makers. A fall in demand for manufactures leads directly to a reduction of output and a rise in unemployment, whereas a fall in the demand for primary products leads directly to a fall in their prices. Secondly, whereas the benefits from higher productivity in manufacturing are largely retained by the producers in the form of higher wages and profits, the benefits of technical progress in primary production are largely passed on to buyers in the form of lower prices.

Volatile primary product prices have, in the last ten years, aggravated both inflation and unemployment; they have discouraged investment in the developing primary exporting countries, and have disrupted the performance of low income exporting countries. The collapse of primary product export prices has been a major contributory cause of the debt crisis. By stabilizing these prices an important source of inflationary impetus is eliminated when demand is high, and a source of unemployment in advanced countries and of poverty in developing countries, when demand is depressed by anti-inflationary policies. The case for buffer stocks is much stronger if it is based on such macroeconomic considerations. If it is the unexpected large jumps and fluctuations in raw material prices that cause stagflation in advanced industrial countries that use these raw materials as inputs into their manufactured products, the smoothing out of such fluctuations would reduce both inflation and unemployment. Mr. Baker in his speech to the IMF in September 1987, has sensed this.

In the longer run, the solution for the developing exporters lies in diversification out of primary products, the demand for which is declining. Here, the USA can set an example of taking a global view. All too often now country A is advised to diversify out of crop X into crop Y, and country B is advised to diversify out of crop Y into X, when both X and Y are in global surplus.

Technology

Appropriate technology for the low income countries is often lacking: technology appropriate to the different factor proportions (labour surplus and capital scarcity), to the different climate, to the different scale of production (small scale), to the lower incomes, investment and savings ratios, to the different soils and to the social and cultural conditions. But even more research on such appropriate technologies — desirable though it is — is not enough. Since technology transfer implies not the movement of pieces of hardware from one country to another, but the transfer of knowledge from the brains of one set of people into the brains of another, there is always a need to build up indigenous technological capacity, particularly in agriculture. The dilemma in the early stages is that there can be a conflict between the need to build up this indigenous capacity, which implies some closing off from foreign influences, and the transfer of what is known abroad, which implies opening up to foreign influences. Closing the communication gap, by opening up the country to foreign influences, may widen the suitability gap, the invention and adaptation of appropriate technologies, because it increases dependence and reduces self-reliance, while closing the suitability gap may widen the communication gap. But a judicious combination of policies can reduce both gaps simultaneously. It would imply strengthening both local research institutions and research institutes in advanced countries specifically concerned with appropriate technologies, encouragement of exchanges among developing countries, the creation of a bank that would pool international information on appropriate technologies, and assistance for strengthening the indigenous technological capacity, to reduce dependence and strengthen self-reliance. This is needed in any case, not only (a) in order to make good use of foreign technology transferred (maintain, run, repair, and replace it), but also (b) in order to adapt foreign technology to local conditions, (c) in order to invent and innovate new appropriate local technologies, and (d) in order to know what the developing country is buying and get better terms for the purchase of technology from foreigners.

Private foreign investment

Much has been written about the role of private foreign investment in development, both in its creative role as a package combining capital, management, marketing and technology, and as a harbinger of exploitation. Without wishing to defend or attack either the proposition that the Ford Motor Company is the nearest thing to the Ford Foundation, or, on the other hand, that private foreign investment is, if not the devil incarnated, the devil incorporated, some useful guidelines can be laid down.

First, it is clear that private foreign investment, to be successful, calls for complementary and supplementary action in the public sector. Roads, railways, ports, airports; education and research, nutrition and health measures for farmers and factory workers are preconditions for productive and remunerative private investment. And the physical and social infrastructure are normally provided by the public sector.

Secondly, the foreign firm should not replace but should encourage the growth of domestic enterprises. In particular the small-scale family enterprises of the informal sector should be encouraged to produce inputs, components, spare parts, repairs and ancillary services for the normally large, foreign firm. Such a symbiotic relationship calls for, first, the removal of discrimination against the informal sector and, second, for credit, information, market access and other institutions that assist the informal sector enterprises to thrive.

In the past, relations between the large (domestic and foreign) enterprises and the small, informal sector firms have often been competitive, with the large firms getting public support. A change to greater complementarity has implications both for institutions (credit, information, marketing) and for policy. To give only one example, the conventional prescription that lower real wages make for higher employment may have to be revised, if higher wages in the organized sector induce firms to contract out labor-intensive activities, previously done in-house to the informal sector firms, where incomes are more flexible.

Thirdly, thought should be given to institutional innovations that combine features of efficient large-scale private management with the objective of social responsibility. The nucleus estates of the Kulai Oil Palm project in Malaysia or the Kenya Tea Development Authority may serve as examples. The basic idea is to combine modern processing, marketing, credit and extension services in a central enterprise with smallholders who grow the crops on their plots of land. This type of institution is particularly suited for agricultural projects, but similar forms can be explored for industrial firms, where production facilities calling for large capital expenditure are located in the central plant and the manufacture of spare parts and components, items that can be produced labor-intensively, and ancillary services such as packaging and transport, are grouped in small enterprises round the central firm. The institutional innovation applies both to the form of organization and to its financing. In principle, there is no reason why both private and public money should not be harnessed to this purpose. Treasury appropriated funds could be used together with funds

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borrowed in the capital market by the US Treasury, together with private investors' participation.

Although the ideological and political divide is still between the private and the public sector, a more relevant line can be drawn between small-scale enterprises, many in the informal sector, run by families with no or only a few employees, and the large institutions, comprising both large private firms and public sector institutions. The former harness the initiative, enterprise and efforts of individuals and spread widely the benefits of growth. The latter are run along bureaucratic lines and, while having the merit of being socially accountable and more easily regulated, they also have the drawbacks of bureaucracies. Much has been written about the distortions caused by government interventions that give rise to "rent-seeking" or "directly unproductive profit-seeking activities". But this is not confined to government activity. In large private firms, exactly the same type of "rent-seeking" and "influence-seeking" is pursued at the cost of economic efficiency. The encouragement of genuinely private and free enterprise can have quite radical implications for developing countries.

Another important area of policy is the imaginative exploration of new legal and business institutions which combine the considerable merits of the transnational corporation with the maximum beneficial impact on national policy objectives. This area comprises joint ventures, i.e., joint both between private and public capital and between domestic and foreign capital, which go further than window dressing by giving the developing host country access to information and decision making, and various provisions for divestment and gradual, agreed transfer of ownership and management from foreigners to the host country. Thus, countries wishing to curb the power of large groups in their manufacturing sector may find investment reduced.

This may make it advisable to institute a "joint sector" in which public capital is combined with private national management with or without an equity stake, or public capital is combined with private international capital. Another possibility would be a management contract with a national or international investor.

Thought and action in this area have suffered from a poverty of the institutional imagination which has lagged behind the advance of the scientific and technological imagination, and the global vision of transnational firms. Discussions have turned partly on the ideological dispute between private and public enterprise. Yet the real issues have little to do with ownership. Mixed companies can be devised that simultaneously harness private energy and initiative, yet are accountable to the public and carry out a social mandate, on the model of the already mentioned British Commonwealth Development Corporation. Equally arid has been the dispute over the virtues and vices of private foreign investment. Here again, the task should be to identify the positive contributions of foreign firms and the social costs they impose on the host country, to see how the former can be maximized or the latter minimized, and to provide for gradual, agreed transfer to national or regional ownership and management. There is a need for a legal and institutional framework in which social objectives that are not normally part of the firm's objectives can be achieved, while giving the firm an opportunity to earn profits by contributing efficient management, marketing and technology.

The quantitative contribution of private foreign investment in the developing countries as a group, and particularly in the poorest countries (outside mining and plantations where these have not been nationalized) is bound to remain small. But its qualitative role as a center round which to cluster numerous small domestic enterprises, and as a potential mobilizer of domestic enterprise remains to be explored.

There has been a good deal of experience in the growth of lending to very small and poor businesses. The Grameen Bank in Bangladesh has been one of the first, but the experience has been replicated in many other countries. One important lesson is that even without collateral, poor people tend to repay the loans. Another is that, combined with some degree of training in book-keeping and management, these loans have multiplier effects that create jobs for other poor people. They break the grip of the usurious moneylender and enable people to start businesses who could not have done so without these loans.

An illustration of a new form of partnership for developing countries

The Transnational Corporation (TNC) clearly has an important part to play in assisting the progress of the developing countries. At the same time a number of obstacles now stand in the way of its greater participation in the development process. New institutions and new procedures are needed to overcome these obstacles.

The obstacles are partly practical, arising from the difficulties of operating in countries with shortages of skilled manpower and basic utilities, and partly political. The latter include the sometimes ambivalent attitudes of the governments of developing countries and the resulting political risks faced by the TNC. The reluctance to welcome whole-heartedly TNCs has itself a number of causes. First, there is the fear, whether justified or not, that it may exploit its market power and deprive the country of valuable resources in general, and, through remittance of profits abroad, aggravate balance of payments difficulties. Second, there is the fear that the enterprise will form a foreign enclave, whose activities will not benefit and may harm the rest of the economy. Third, political fears of foreign domination or interference may add fuel to economic fears of exploitation. The debt crisis has greatly reduced these fears, and many developing countries are now welcoming TNCs. But areas of friction remain.

Foreign enterprise has the capacity of bestowing great benefits on the economy of the host country. It can combine the provision of capital, of a team of skilled men and access to markets; it can transmit rapidly the latest products and technology to the host country; it can encourage the growth of a number of ancillary domestic enterprises; and it can reduce the economy's dependence on imports and increase its capacity to export.

The international community could help by investigating ways in which the fears of both overseas governments and private firms can be allayed and the advantages maximised. This could be done by devising a form of joint enterprise through which finance, skilled manpower and training are provided in a way which is acceptable to the host governments and which carries sufficient profit to be attractive to the foreign firms.

One way of achieving this would be for a private firm to establish a joint enterprise with a local government or a government agency, such as a local development corporation. The foreign firm should put up not more than 49% of the capital, but enough to benefit when the enterprise succeeds, and of course suffer if it fails. It should have a substantial minority interest, while the local government has the dominant interest.

Such a holding would often be sufficient to secure a decisive role in management. But it might be possible to arrange in special circumstances that, in the initial phase, the foreign investor should hold a higher percentage of the equity, as long as the arrangement for eventual transfer to local ownership is clearly stated. The foreign firm might also provide some of the money on a fixed interest basis or in the form of preference shares.

The equity interest of the foreign firm would be bought out by the local government at the end of a suitable pre-arranged period. This period could be ten years, with provision each year after say 7 years to extend for a further 5 years up to say 15 years, or longer in the case of e.g. plantation enterprises. Various other forms of "rolling" continuation could be devised, such as a possible extension of another 5 years, etc. Alternatively, the period could be longer, but there could be options at fixed points when either the local government could buy out or the firm sell out.

Managerial and technical staff would initially be provided almost exclusively by the foreign firm, perhaps under a management contract, but with the obligation to train local replacements within the specified period before buy-out. The rate of replacement could not be specified contractually, but the local government would be able to use its representation on the board to ensure that it went forward at a satisfactory pace.

Housing and community services should be provided by the local government or appropriate local statutory body set up for the purpose. In view of the relatively short period of ownership participation, the foreign firm's capital should be concentrated on productive activities.

The scheme would operate through a tripartite agreement between the parent government of the firm, the local government and the private firm

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concerned. The parent government and the local government would provide a guarantee against expropriation. The parent government (or the World Bank) might also provide aid funds in appropriate cases to enable the local government to finance its participation or, either directly or through one of the international financial institutions, to help finance housing or community services required for the project.

Procedures for assessing an appropriate value at the time of buy-out would have to be agreed upon in advance, as well as procedures for arbitration should disputes arise.

Advantages

Most of the advantages of private enterprise are preserved. The foreign firm brings in capital, together with technology, market access and a team, possibly with local experience, and the overhead facilities and international experience which the firm can provide are thus made available.

At the same time the fears which local governments or public opinion may feel are removed. The opportunity for exploiting indefinitely a monopoly or oligopoly position no longer exists. The fear of foreign ownership and domination is removed.

The TNC, on the other hand, acquires a guarantee against expropriation, combined with the incentive to enjoy a share in the profits. Clearly it would still carry the commercial risks of failure, but political risks would be eliminated.

The buy-out arrangement after an agreed period releases capital and know-how. These very scarce resources can thus be used on a revolving basis for initiating and pioneering new ventures and are freed from maintaining a going concern, which can more easily be transferred to local shoulders. The "spread effects" of enterprise on the rest of the economy are thus increased.

Fields of application

The scheme would be particularly suitable for large-scale agricultural enterprises and for countries with a small entrepreneurial and managerial class. If new enterprises were successfully established, existing ones might also be converted into this type. Regimes committed to replacing foreign by domestic economic activity might, instead of expropriation, be persuaded to work for the transformation of foreign-owned enterprises into the new type of joint venture.

If such a scheme were to be accepted by the parent governments, it would be desirable to present it as a form of transfer which combines adaptability to different circumstances with sufficient concreteness to have an appeal. It would need to be announced with a good deal of publicity, after careful preparation and consultation with selected host governments and TNCs.

The total relationship

The aid relationship between the USA and poor countries has sometimes been isolated from other policies and presented as an indicator of international cooperation. Yet, a country can perform well on aid and yet undo a multiple of any good done on this front by policies in other directions; and a country can do little for aid, but yet have a highly beneficial impact through its other policies. If international cooperation is taken seriously, the impact of <u>all</u> policies on the low income countries should be one of the considerations entering into policy design. Trade is clearly important, particularly since most developing countries, if given the choice, prefer trade to aid. Agricultural policy, industrial policy, regional policy, taxation relating to foreign investment, monetary and fiscal policies all can have an important impact on low income countries, even though this is not part of the design.

In the past, the combination of loose fiscal and tight monetary policies, adopted by the Reagan administration, was harmful to low income countries. Although the large US trade deficit encouraged exports from the developing countries, the high interest rates (a) increased the debt burden, (b) slowed down growth of demand in the USA, and (c) induced other OECD countries to follow in order to avoid excessive capital flight. The harmful consequences of these effects outweighed any beneficial impact on import demand. Many times more important than any likely specific aid or trade concessions would be the resumption by the USA of higher growth, with accompanying higher demand for imports, and lower interest rates, which would lighten the debt burden. In addition to economic policies, the thrust of foreign policy, strategic policy and education policy also affect the developing countries.

If this argument of the total relationship is accepted, it might call for a revision of the organizational structure of development policy. Many countries have Ministries of Development whose task it is not just to dispense aid, but to bring to bear on all policy decisions their impact on the developing countries. On the other hand, the danger of a separate department for international cooperation is that other departments may feel themselves freed from having to look after the development impact of their policies and cooperation then may go by default. On balance, a strong department of cooperation, with cabinet rank, is probably necessary until everyone has become sensitized to the issues.