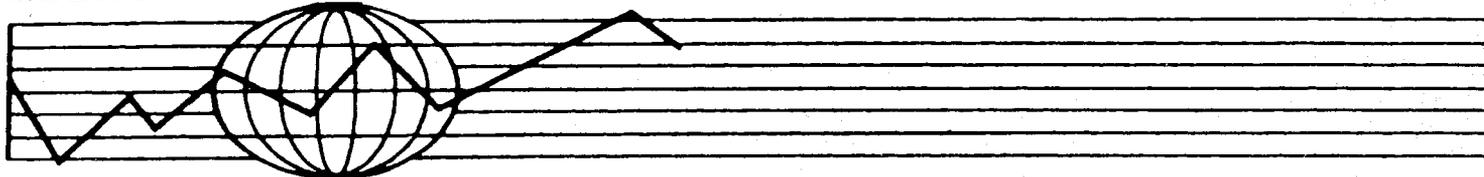


**ECONOMIC DEVELOPMENT CENTER**



## WHY FOREIGN ECONOMIC ASSISTANCE?

Vernon W. Ruttan

ECONOMIC DEVELOPMENT CENTER  
Department of Economics, Minneapolis  
Department of Agricultural and Applied Economics, St. Paul

UNIVERSITY OF MINNESOTA



Why Foreign Economic Assistance?\*\*\*

Vernon W. Ruttan\*

\*Regents Professor, University of Minnesota. I am indebted to Dennis Ahlburg, Charles Beitz, Douglas Dion, Maureen Kilkenny, Anne O. Krueger, H. E. Mason, Michael Root, C. Ford Runge, Rolf Sartorius and John Wallace for comments on an earlier draft of this note.

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Vernon W. Ruttan\*  
University of Minnesota

There is general agreement in the economics literature that resource flows among countries in response to market incentives enhance global economic efficiency and welfare in both rich and poor countries. It has also been argued that in the presence of capital market imperfections the transfer of resources from developed country governments to the governments of developing countries on commercial terms, either directly or through multilateral agencies, can normally be expected to be welfare-enhancing in both developed and developing countries.<sup>1</sup> These arguments do not apply, however, to official development assistance that involves a substantial grant element.

Two arguments have typically been used in support of transfers that include a grant component. One set of arguments is based on the economic and strategic self-interest of the donor country. A second set of arguments is based on the ethical or moral responsibility of the residents of wealthy countries toward the residents of poor countries. Both sets of arguments have been the subject of continuous challenge.

I argue in this paper that neither the donor self-interest nor the ethical responsibility argument can be rejected on logical or theoretical grounds. I also argue that the empirical evidence in support of both the economic and the strategic self-interest arguments is exceedingly weak. The ethical responsibility arguments impose less burden on the empirical evidence. But, they have been subject to continuous challenge by political theorists and moral philosophers.

#### Donor Self-Interest

Donor self-interest arguments tend to assert that development assistance promotes the economic or political interests of the donor country. This argument is frequently made in official and popular pronouncements in defense of developed country aid budgets.<sup>2</sup> The donor self-interest argument has also been made by the critics from the left who assert that aid impacts negatively on political and economic development in poor countries.<sup>3</sup> The empirical evidence suggests that donor self-interest plays a relatively large role in bilateral assistance while recipient need plays a larger role in multilateral assistance.<sup>4</sup>

#### Economic Interest

Most economic self-interest arguments employ some version of the argument that aid promotes exports from and employment in the donor country. The crude version of this argument simply appeals to the obvious gains to the U.S. economy from

exports of commodities or services or to the specific industries whose commodities or services are subsidized by the assistance program. U.S. producers of food grains benefit from food assistance, workers in the maritime industry gain from cargo preference provision, and U.S. engineering firms gain from contracts associated with infrastructure development projects. Programs to protect private overseas investment against economic and political risk have been a prominent component of U.S. and many other national assistance programs.<sup>5</sup>

A somewhat less obvious appeal to specific interests often emphasizes the generalized role of aid in strengthening commercial ties between the donor and the recipient. Commercial contacts developed during a period of assistance for the development of a nation's transportation or communication network can be expected to continue. As the recipient country's infrastructure develops, commercial demand for new and replacement equipment compatible with the aid-assisted investments is expected to widen commercial sales opportunities. Similarly, technical assistance for the development of an LDC grain milling and feed processing industry is viewed as enhancing the commercial demand for food and feed grains from the donor country.

A more sophisticated argument is often made that if aid is effective in contributing to LDC economic growth the effect will be an expansion of demand for those DC goods and services characterized by high import demand elasticities.<sup>6</sup> U.S.

agricultural producers are urged not to become overly concerned about loss of, for example, oilseed markets to Malaysia and Brazil because as incomes rise, growth in demand for animal proteins will generate demand for U.S. feed grains. Loss of exports by the mature industrial sectors will be more than compensated for by capital goods and high technology exports.<sup>7</sup>

The first two arguments rest on relatively weak logical foundations. The use of assistance resources to subsidize domestic suppliers of commodities or services generally reduces the value of a given level of assistance to the recipient country.<sup>8</sup> This concern has generated a vigorous argument about the value and impact of food assistance.<sup>9</sup> Other areas, such as tied procurement of such services as technical assistance, have been subject to much less controversy. But there can be little question that the effect of aid tying is to raise the cost to the donor of providing whatever benefits recipients receive from development assistance.

The growth impact argument rests on stronger logical grounds. It should be technically possible to specify conditions under which government-to-government aid transfers involving a grant element could improve welfare in both donor and recipient countries.<sup>10</sup> The empirical analysis to support this argument is, however, surprisingly limited. It is not sufficient simply to assert that the transfer of assistance resources may be followed by the growth of exports from the donor to the recipient country. The welfare gains and losses

to donors and recipients must be calculated. As of yet neither the contribution of aid recipients' growth on donor trade balances nor the welfare gain and loss calculations have been made.<sup>11</sup>

### Political and Strategic Interest

The view that development assistance is a useful complement to other elements of donor political strategy--that its primary rationale is to strengthen the political commitment of the aid recipient to the donor country or to the West--has been a consistent and at times dominant theme in the motivation for development assistance.<sup>12</sup> Political considerations in both donor and recipient countries have, however, often made it advisable to cloak the objectives of short-term political or strategical assistance with the rhetoric of economic assistance--hence terms such as economic support fund in the USAID budget.<sup>13</sup>

The strengthening of the capacity of Western Europe to resist external aggression and the enhancement of the political appeal of centrist political forces were major motivations for the Marshall Plan.<sup>14</sup> Strategic concerns were a prominent feature of the Kennedy administration's "Alliance for Progress" in the early 1960s.<sup>15</sup> The Carlucci report, commissioned by the Reagan administration, insisted that "the foreign security and economic cooperation programs of the United States are mutually supportive and interrelated and together constitute an integral part of the foreign policy of the United States."<sup>16</sup> The

commission urged that efforts be made to enhance the complementarity between U.S. economic and security programs through the creation of a Mutual Development and Security Agency that would bring development, military, and related assistance programs under one agency.

One of the issues that one would like to see examined more fully is the issue of complementarity and conflict between the achievement of short-run political strategic objectives and longer-run political development in the recipient country. It is not too difficult to find examples of cases where donor efforts to achieve short-run political or economic objectives appear to have been inconsistent with longer-term recipient political development (Vietnam, Nicaragua, Philippines). A common assumption in the earlier literature was that Western style "democratization" and "bureaucratization" would be in the interest of both the donor and the recipient. But the study of political development has provided few guidelines for policy makers or practitioners who would guide political development along mutually advantageous lines.<sup>17</sup>

#### In Summary

There is an interesting dichotomy in the dialogue about the use of foreign assistance in the pursuit of domestic economic and strategic interests. It is clear that self-interest and security arguments have often represented little more than cynical efforts to generate support for the foreign

assistance budget. There have been serious efforts to examine the theoretical foundations of the economic self-interest argument. There have also been increasingly serious attempts to evaluate the economic and social impacts of economic assistance in developing countries. In addition to a large professional literature, the U.S. Agency for International Development has conducted and published more than 100 Project Evaluations, Evaluation Special Studies, and Program Evaluation Reports. The World Bank has an Operations Evaluation Department that engages in a major program of project completion evaluation studies.

The security rationale has not, however, been subject to nearly as rigorous theoretical or empirical analysis.<sup>18</sup> The single background paper on the effectiveness of military assistance prepared for the Carlucci Commission asserted a positive linkage between U.S. security assistance expenditures and security interests while admitting that the evidence to support the assertion is "elusive."<sup>19</sup> This is not to suggest that empirical support cannot be provided to support the political and strategic self-interest arguments. It is simply to argue that, in spite of Huntington's assertion that the results of security assistance have been at least as successful as efforts to promote economic development,<sup>20</sup> little convincing evidence has appeared in the professional literature on development assistance.

There is an inherent contradiction in both the economic and the security self-interest arguments. There is a danger that donor countries may pursue their self-interest under the rubric of aid even if it harms the recipient country. If the donor self-interest argument is utilized as a primary rationale for development assistance it imposes on donors some obligation to demonstrate that its assistance does no harm to the recipient.

One effect of the economic and security self-interest arguments has been to clarify that donor governments and assistance constituencies are not indifferent to the form of the resource transfers they make to poor countries. Security assistance draws on a set of ideological concerns that often go beyond a rational calculation of donor self-interest. Food aid taps not only the self-interest of donor commodity producers but also a powerful set of altruistic concerns in donor countries about poverty, hunger, and health in poor countries.<sup>21</sup> It is doubtful that these forms of assistance are directly competitive--if food aid were reduced, the resources released would not become available to support the security assistance budget.

#### Ethical Considerations

Efforts to develop an acceptable rationale for development assistance have not been confined to self-interest arguments and rationalizations. There has been an extended argument

about the moral responsibility of rich countries to assist in reducing poverty and enhancing economic development in poor countries over and above any considerations of self-interest. But neither the advocates nor critics of foreign assistance have adhered to careful distinctions between self-interest and moral responsibility.

The typical criticism of foreign assistance starts out with an argument that the resources devoted to foreign assistance have been wasted--that assistance has not achieved either its intended economic or political objective. The argument then tends to be followed by an argument that in any event it is not legitimate, within the framework of Western political philosophy, for government to forcefully extract resources from citizens in order to transfer them to foreigners.<sup>22</sup>

Both the popular and official sponsors of foreign assistance have typically treated the ethical basis for foreign assistance as intuitively obvious.<sup>23</sup> There is, however, a substantial professional literature that has attempted to identify a basis in ethical theory or political philosophy for income or resource transfers made to enhance welfare in a recipient country even when the transfer is at the expense of a reduction in welfare in the donor country. In addition, since government-to-government transfers are often involved, an attempt is sometimes made to explore the basis for a claim by

the recipient country for assistance or of the obligation of the donor country to the recipient country.

### Entitlement

An argument frequently put forth during the "New Economic Order" dialogue of the 1970s was that there should be compensation by the rich countries to poor countries for past injustices stemming from political domination and economic exploitation.<sup>24</sup>

A second entitlement argument is based on the uneven distribution of natural resources. It has been argued that natural resources are part of our global heritage and that those areas that are favorably endowed have an obligation to share rents from differential resource endowments with those areas that are less favorably endowed.<sup>25</sup>

The argument based on past injustice, while correct in principle, poses substantial difficulties for translation into contemporary assistance policy. If exploitation occurred and compensation was not made, the effect of compound interest is to magnify the size of the obligation. Much of the assistance provided by Great Britain and France, the two major colonial powers, has been directed to former colonies and dependencies. Lenin's model of imperialism, in which capital was exported to low-income staple-producing areas under the direct or indirect political control of the major powers and which earned enormously high rates of return for a narrow class of investors in the metropolitan country has, not held up even to casual

examination.<sup>26</sup> It has been difficult to establish the extent to which the imperial relation was, in fact, exploitative.<sup>27</sup> A more relevant argument in a world of both overt and "voluntary" constraints on the movement of commodities, labor, and financial resources is that developed countries have inadequately "exploited" the human and physical resources of the poor countries.

It is also difficult to decide what weight should be given to the natural resource distribution argument. One can hardly argue that the inhabitants of Kuwait and Somalia "deserve" the differential resource endowments they have inherited. Yet natural resource endowment differentials do not represent a very powerful factor in explaining differential growth rates among either developing or developed countries. The difficulty of converting staple exports into a base for sustained national or regional economic development has been a difficult challenge even in situations that have not been characterized by obvious exploitations--except in the rather meaningless Marxian view that insists that all production and exchange are characterized by exploitation.<sup>28</sup> Perhaps the area in which the natural resources distribution issue is of greatest contemporary significance is the debate about the management and distribution of the potential rents associated with the exploitation of the global commons--the ocean and space resources.<sup>29</sup>

### Distributive Justice

Most economists have generally felt fairly comfortable-- perhaps too comfortable--with a straightforward utilitarian rationale for foreign assistance. If private rates of return to capital investment are higher in developing countries than in developed countries, investment should flow from developed to less developed countries. If, because markets are imperfect, social rates of return exceed private rates of return, then developed country governments should transfer resources to developing countries to assist in physical and institutional infrastructure development. But few economists would be willing to embrace the full implications of the utilitarian income distribution argument--that rich countries ought to give until the point is reached at which by giving more, the loss in utility in the donor country would exceed the gain in utility in the recipient country or countries.

In contrast, most political philosophers, and those economists who adhere to a Hobbesian contractarian view of the role of government, have found it difficult to discover any intellectual foundation for development assistance based on considerations of distributive justice. At the most extreme there is the argument by Hayek that in a society of free men the concept of social or distributive justice has no meaning. "Justice has meaning only as a rule of human conduct and no conceivable rules for the conduct of individuals supplying each other with goods and services in a market economy would produce

a distribution which could be meaningfully described as just or unjust."<sup>30</sup> Hayek argues, in effect, that justice is a function of the rules or processes that govern individual and group behavior and not of the outcome generated by the rules. The appropriate role of public policy is rule reform.

The Hobbesian contractarian argument with respect to foreign aid has been forcefully articulated by Banfield: "... our political philosophy does not give our government any right to do good for foreigners. Since the seventeenth century, Western political thought has maintained that government may use force or threat of force to take the property of some and give it to others only if doing so somehow serves the common good...government may take from citizens and give to foreigners when doing so serves the common good of the citizens, but it may not do so if ... all advantage will accrue to foreigners and none to citizens."<sup>31</sup> This argument has been forcefully restated by Nozick,<sup>32</sup> and it has recently reemerged with renewed force in the debate over foreign assistance in the late 1970s and early 1980s.<sup>33</sup> It seems apparent that the emergence of social justice as a significant issue on the political agenda, both within nations and in international relations, is due to lack of confidence that the actual behavior of economic markets and political institutions adequately approaches the conditions specified by Hayek, Nozick, and other libertarian political philosophers.<sup>34</sup>

Attempts have been made to develop a contractarian argument drawing on the Rawlsian "difference principle" to establish a moral obligation for foreign assistance. The central part of Rawls' theory is that in a just society departures from an equalitarian income distribution would be permitted only when differential rewards contribute to the welfare of the least advantaged members of society. Rawls argues that this "difference principle" would be agreed to by rational individuals attempting to design a constitution--given full general knowledge of the political and economic nature of society except the positions that they would occupy by virtue of social class, individual talent, or political persuasion. The Rawlsian constitution does not imply perfect equalization of incomes. If, for example, inequality calls forth economic activity that benefits the least as well as the more advantaged members of society, it would be permitted.<sup>35</sup>

Rawls made no attempt to explore the implications of the difference principle for international inequality. Beitz and Runge have argued that an intuitively obvious extension of the difference principle to the international economic order is that justice would imply equal access by citizens of all countries to global resources except in those cases where departure from inequality could be justified on the basis of benefits to citizens of the least advantaged countries.<sup>36</sup> This argument goes beyond the "past injustice" resource entitlement argument discussed above. To the extent that it draws on the

Rawls framework, however, it remains vulnerable to the weakness of attempting to derive rules of justice from an "imagined social contract."<sup>37</sup> I would personally prefer a stronger behavioral foundation on which to rest convictions about moral responsibility for assistance to poor countries. This preference reflects a more general skepticism about both the contractarian approach to political philosophy and the public choice approach to political economy that attempt to derive principles for the design of social and economic institutions from primitive assumptions about human nature.

A second level of argument insists that both the moral and rational arguments that have been used to support ethical responsibility for distributive justice apply to individuals (or families) and not to collectives such as nations.<sup>38</sup> The problem of extending the ethical arguments that have been developed to apply to individuals to nations has been difficult to resolve in spite of the strong popular sentiment that rich nations do have some responsibility for assisting poor nations to achieve adequate levels of nutrition, health, and education.

"Much recent discussion on transfer of resources falls uncritically into the practice of ... anthropomorphizing nations, of treating nations as though they are individuals and extrapolating to them on the basis of average per capita income the various ethical arguments that have been developed to apply to individuals. This is not legitimate. If ethical arguments are to be used as a rationale for transferring resources,

either a new set of ethical principles applicable to nations must be developed, or the link between resource transfers must be made back to the individuals who are the ultimate subjects of standard ethical reasoning."<sup>39</sup>

#### An Implicit Global Contract

A contractarian argument that limits the responsibility of the rich toward the poor to national populations has great difficulty in confronting a world where citizens hold multiple loyalties, where national identity may be wider or more narrow than state boundaries, where policy interventions as well as market forces guide the flow of labor and capital and the trade in commodities and intellectual property across state boundaries.<sup>40</sup> In this world a "state-moralist" or "political realist" approach to international relations that would limit the expression of the moral concerns of either individual citizens or national governments about the basic political rights or subsistence needs of people in other countries seems curiously archaic.

Increased interdependence among nations results in a rise in both political tension and concern about lack of equity in economic transactions. The ethical foundation for a system of development assistance rests on the premise that the emergence of international economic and political interdependence has extended the moral basis for social or distributive justice from the national to the international sphere. This international interdependence has resulted in an implicit

extension of Arrow's argument for redistribution to include the international sphere: "There are significant gains to social interaction above and beyond what individuals can achieve on their own. The owners of scarce personal assets do not have substantial private use of these assets; it is only their value in a large system which makes these assets valuable. Hence, there is a surplus created by the existence of society which is available for redistribution."<sup>41</sup>

The growth of global and political interdependence implies a decline in the significance of national boundaries. Since boundaries are not coextensive with the scope of economic and political interdependence, they do not mark the limits of social obligation in the sharing of the benefits and burdens associated with interdependence.<sup>42</sup> A functioning international economy increases the value of the natural, human, and institutional resources of the developed countries and makes part of this surplus available for redistribution.

#### Some Questions

Acceptance of an ethical responsibility by the citizens and the governments of rich countries for assistance to poor countries still leaves unanswered a number of important questions.

Acceptance of an ethical responsibility for development assistance by the rich countries does not resolve the question of what level of assistance is appropriate. It was noted earlier that the utilitarian or consequentialist argument seems

to be based on equating marginal utilities--the rich countries ought to give until the point is reached at which by giving more, the loss in utility in the donor country would exceed the gain in utility in the recipient country or countries.<sup>43</sup>

However, the actual level of aid allocations by donor countries seems to reflect the much weaker moral premise that if it is possible to contribute to welfare in poor countries without sacrificing anything of moral or economic significance in the donor country it should be done.<sup>44</sup> There seems to be an implicit moral judgment among the citizens and governments of the rich countries that the moral obligation to feed the poor in Ethiopia is stronger than a moral obligation to assure a 6 percent rather than a 5 percent per year rate of growth in Ethiopian GNP.<sup>45</sup>

Neither the commitment to development assistance nor the commitment to a particular level of development assistance provides guidance as to who should receive aid. The acceptable ethical considerations that support the distributive justice argument imply that assistance should be directed to improving the welfare of the poorest individuals in the poorest countries. But there is also an ethical argument that aid should be directed into uses that produce the largest increments of income from each dollar of assistance--the argument that assistance resources are limited and should not be wasted.

The empirical evidence does not permit any clear inferences concerning aid impact on savings, investment, and rate of growth. There is, however, evidence that assistance resources have generated relatively high marginal rates of return--rates of return that are high relative to what the same resources would have earned in the donor countries.<sup>46</sup> What little empirical evidence we do have also suggests that donor governments are willing to trade off some efficiency for equity in their aid allocations--that recipient income levels do carry modest weight in the allocation of aid resources.<sup>47</sup> But we have little more than anecdotal evidence on the distributive impacts of development assistance in recipient countries.<sup>48</sup>

Acceptance of responsibility for assistance does not resolve the question of what form of assistance to offer. The goals of assistance range from attempting to assure immediate "subsistence rights" or basic needs,<sup>49</sup> to assistance designed to strengthen the capacity of a nation to meet the subsistence requirements of its own people, or to modifying the institutions that influence the resource flows among nations. On some grounds it would seem obligatory to secure some minimum level of subsistence before allocating resources to the other two objectives. But this conclusion is not at all obvious if the effect is to preclude either (a) expansion of the capacity needed to assure future subsistence or (b) reform of the rules of conduct that govern economic and political relationships

among nations (i.e., reforming of the GATT rules on agricultural trade).

A fourth issue is the extent to which development assistance policy and administration should be directed to bringing about institutional reform in the recipient country.

The extent to which development assistance directed either toward meeting basic needs or to strengthening the recipient countries' capacity for economic growth will depend on the institutions that influence relations among individual citizens, economic and social organizations, and the government. Different institutional arrangements will influence how different socio-economic classes, different ethnic groups, and residents of rural and urban areas participate in programs designed to meet basic subsistence, health, and education objectives. Different institutional arrangements with respect to the organization and stability of property rights and the system by which the public revenue is generated and spent will affect the production decisions of farmers and the investment decisions of industrial entrepreneurs.

If a donor government's ethical concern extends to an obligation to assure the citizens of the donor country that the resources devoted to assistance are used effectively, either for immediate relief of subsistence needs or to generate longer-term economic growth, it can hardly avoid also entering into a dialogue with the recipient country about institutional

reform when it enters into negotiations with a recipient country about resource transfers. The rationale for focusing on institutional reform is the hope that the moral concern that provided a rationale for assistance will contribute to capacity in the recipient country to more effectively provide for basic needs and generate the growth necessary to improve the quality of life.<sup>50</sup> The obligation to enter into a dialogue on issues of institutional reform imposes on the donor country the requirement to build the capacity in its own cultural and social science disciplines necessary to enter into the dialogue. These capacities should be guided more by pragmatic consideration about the potential impact of policy reform in the recipient country than either ideological considerations based on the donor's internal political processes or its own economic or political self-interest.

#### In Conclusion

The first conclusion that emerges from this review is the weakness of the self-interest argument for foreign assistance. The individual (or group) self-interest arguments, when examined carefully, often turn out to represent a hidden agenda for domestic rather than international resource transfers. The political "realists" have not been able, or have not thought it worthwhile, to demonstrate the presumed political and security benefits from the strategic assistance component of the aid budget. Rawlsian contractarian theory does provide a basis for

ethical responsibility toward the poor in poor countries that goes beyond the traditional religious and moral obligations of charity. It also provides a basis for making judgments about the degree of inequality that is ethically acceptable.

But the contractarian argument cannot stand by itself. The credibility of the contractarian argument is weakened if, in fact, the transfers do not achieve the desired consequences. Failures of analysis or design can produce worse consequences than if no assistance had been undertaken.<sup>51</sup> There is no obligation to transfer resources that do not generate either immediate welfare gains or growth in the capacity of poor states to meet the needs of their citizens. It becomes important, therefore, to evaluate the consequences of development assistance and to consider the policy interventions that can lead to more effective development assistance programs.

Since the 1950s our understanding of the development process has made major advances. But we can never fully know the consequences of any assistance activity or intervention into complex and interdependent social systems. Our limited knowledge about how to give and use aid to contribute most effectively contribute to development does not, however, protect us from an obligation to assess the consequences of either our strategic or development assistance or to advance our capacity to understand the role of external assistance in the development process.

## Notes

\* Regents Professor, University of Minnesota. I am indebted to Dennis Ahlburg, Charles Beitz, Douglas Dion, Maureen Kilkenny, Anne O. Krueger, H. E. Mason, Michael Root, C. Ford Runge, Rolf Sartorius and John Wallace for comments on an earlier draft of this note.

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