As a journal, Development and Change distinguishes itself by its multi-disciplinary approach and its breadth of coverage, publishing articles on a wide spectrum of development issues. Accommodating a deeper analysis and a more concentrated focus, it also publishes regular special issues on selected themes. Development and Change and Blackwell Publishing collaborate to produce these theme issues as a series of books, with the aim of bringing these pertinent resources to a wider audience.

Titles in the series include:

Catalysing Development? A Debate on Aid
*Jan Pronk et al.*

State Failure, Collapse and Reconstruction
*Edited by Jennifer Milliken*

Forests: Nature, People, Power
*Edited by Martin Doornbos, Ashwani Saith and Ben White*

Gendered Poverty and Well-being
*Edited by Shahra Razavi*

Globalization and Identity
*Edited by Bergit Meyer and Peter Geschiere*

Social Futures, Global Visions
*Edited by Cynthia Hewitt de Alcantara*
Catalysing Development?

A Debate on Aid

Jan P. Pronk et al.
# Contents

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes on Contributors</td>
<td>vii</td>
<td></td>
</tr>
<tr>
<td>Preface</td>
<td>xi</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Aid as a Catalyst</td>
<td>1</td>
</tr>
<tr>
<td>Jan P. Pronk</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Unpacking Aid</td>
<td>21</td>
</tr>
<tr>
<td>James K. Boyce</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Aid as a Flight Forward</td>
<td>29</td>
</tr>
<tr>
<td>Louis Emmerij</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Aid is an Unreliable Joystick</td>
<td>43</td>
</tr>
<tr>
<td>Gud Edgren</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Development Goals, Governance and Capacity Building: Aid as a Catalyst</td>
<td>51</td>
</tr>
<tr>
<td>John Degnbol-Martinussen</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Age of Reverse Aid: Neoliberalism as Catalyst of Regression</td>
<td>63</td>
</tr>
<tr>
<td>James Petras and Henry Veltmeyer</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Aid, Conditionality and Development</td>
<td>77</td>
</tr>
<tr>
<td>Ajit Singh</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>The Effectiveness of Policy Conditionality: Eight Country Experiences</td>
<td>89</td>
</tr>
<tr>
<td>A. Geske Dijkstra</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Aid and the Geopolitics of the Post-Colonial: Critical Reflections on New Labour’s Overseas Development Strategy</td>
<td>117</td>
</tr>
<tr>
<td>David Slater and Morag Bell</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Good Governance and Aid: Selectivity Criteria in Development Assistance</td>
<td>143</td>
</tr>
<tr>
<td>Wil Hout</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>International Development Targets and Official Development Assistance</td>
<td>161</td>
</tr>
<tr>
<td>Santosh Mehrotra</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Contents

12 Aid Effectiveness and Policy Ownership
   Rehman Sobhan
   171

13 It is Possible to Just Give Money to the Poor
   Joseph Hanlon  
   181

14 Aid as a Catalyst: A Rejoinder
   Jan P. Pronk  
   201

Index  
   209
Notes on Contributors

Morag Bell is Professor of Cultural Geography at Loughborough University. She has research interests in cultural geographies of British imperialism and its legacies: her recent work draws on postcolonial critiques to examine the role of international philanthropy in the exercise of western cultural power. She has published widely on these themes.


At the time of writing his contribution to this volume, John Degnbol-Martinussen was Professor of Development Economics and Political Science, Dean of the Graduate School of International Development Studies, Roskilde University, and Chairman of the Danish Council for Development Co-operation. Sadly, Dr Degnbol-Martinussen passed away in 2002.

A. Geske Dijkstra is Associate Professor in Economics in the Faculty of Social Sciences of Erasmus University, The Netherlands. Her research interests focus on the effectiveness of aid and debt relief, including both macroeconomic and political economy effects of the aid system, and on the impact of economic liberalization and reforms. Her most recent books are *Programme Aid and Development: Beyond Conditionality* (Routledge, 2003, co-authored with Howard White) and *Towards Sustainable Development in Central America and the Caribbean* (Palgrave, 2001, with Anders Danielson).

Gus Edgren is a Swedish development economist and development aid administrator, who has worked with the Swedish Government, the trade union movement, and various United Nations organizations. He has been a part of the ILO’s World Employment Programme, has headed the Asian Employment Programme (ARTEP), served as State Secretary for Development Co-operation in the Swedish Government, Assistant Administrator of UNDP, Assistant Director-General of Sida, and as Sweden’s Ambassador to Vietnam. He has written on wage and employment policy, labour standards and foreign trade, aid and development and on the political economy of development co-operation.

Louis Emmerij was Rector of the Institute of Social Studies, The Hague, President of the OECD Development Centre in Paris, and Special Advisor
to the President, Inter-American Development Bank, Washington. Since
1999 he has been Co-Director of the United Nations Intellectual History
Project and Senior Research Fellow at the Graduate Center, City University
of New York.

**Joseph Hanlon** is a Senior Lecturer in the Development Policy and Prac-
tice group of the Open University, Milton Keynes, UK. He is the author of
five books on Mozambique including *Mozambique: Who Calls the Shots*
in Mozambique* (James Currey, 1996), and *Mozambique and the Great Flood
of 2000* with Frances Christie (James Currey, 2001). He is also the editor of
the *Mozambique Political Process Bulletin*.

**Wil Hout** is Associate Professor of World Development at the Institute of
Social Studies, The Hague, The Netherlands. He has written many journal
articles on issues of international political economy; he is the author of
*Capitalism and the Third World* (Edward Elgar, 1993), co-editor of
*Regionalism across the North–South Divide* (with Jean Grugel; Routledge,
1999) and co-editor of three Dutch-language volumes on issues of
international relations and political science.

**Santosh Mehrotra** is currently Senior Economic Adviser, The Human
Development Report at the UNDP, New York; from October 2004, he will
be Lead Economist for Asia, based in the UNDP Regional Centre, Bangkok.
He previously led Unicef’s research programme on economic and social
policy for developing countries at the Innocenti Research Centre, Florence,
Italy. His published works include: *India and the Soviet Union: Trade and
Technology Transfer* (Cambridge University Press, 1990); and *Development
with a Human Face: Experiences in Social Achievement and Economic Growth*
(Oxford University Press, 1997). Three co-authored books are forthcoming:
*Financing Elementary Education: Uncaging the Tiger Economy in India and
Public Spending for the Poor: Getting the Fundamentals Right in Macroeconomic and Social Policy* (both from Oxford University Press); and
*Informal Work in the Value Chain: Protecting Workers Locally against Capital Investing Globally*.

**James Petras** is Professor Emeritus of Sociology, Binghamton Univer-
sity, New York and Adjunct Professor, St. Mary’s University, Halifax,
Canada. He is author and co-author of numerous studies on Latin America
and world development, including *Unmasking Globalization* (Zed Books,
2001) and *Brasil de Cardoso: Expropriação de um país* (Petrópolis: VOZES,
2001).

**Jan P. Pronk** has served in several governments of the Netherlands as
Minister of Development Co-operation (1973–77 and 1989–98) and as
Minister for Environment (1998–2002). Presently he holds a Chair in the
Theory and Practice of International Development at the Institute of Social
Studies, The Hague, The Netherlands. In June 2004, the Secretary-General of the UN, Kofi Annan, appointed Jan Pronk as his Special Representative for Sudan.

Ajit Singh is currently Professor of Economics at the University of Cambridge, UK, and Senior Fellow at Queens’ College. He has been a senior economic advisor to the governments of Mexico and Tanzania and a consultant to various UN development organizations. His most recent publications include a co-edited volume with C. Howes, *Competitiveness Matters: Industry and Economic Performance in the US* (University of Michigan Press, 2000) and the policy monographs, *The Global Labour Standards Controversy: Critical Issues for Developing Countries* (South Centre, 2000, co-authored with A. Zammit), and *Global Economic Trends and Social Development* (United Nations Research Institute for Social Development, Geneva, 2000).

David Slater is Professor of Social and Political Geography at Loughborough University, UK. He is author of *Territory and State Power in Latin America* (Macmillan, 1989), co-editor of *The American Century* (Blackwell, 1999) and an Editor of *Political Geography*. His research focuses on geopolitics, development and social movements.

Rehman Sobhan is currently Chairman, Centre for Policy Dialogue, Dhaka, Bangladesh, and Executive Director of the South Asia Centre for Policy Studies. He was Chairman of the Board of Directors of Grameen Bank for six years. He has published extensively on issues of aid policy, economic reforms, poverty eradication, governance and regional economic cooperation. His recent publications include *Bangladesh: Problems of Governance, Agrarian Reform and Social Transformation; Aid Dependence and Donor Policy: The Case of Tanzania, Transforming Eastern South Asia; and Rediscovering the Southern Silk Route*. He is currently working on the theme of ‘Correcting Structural Injustice: Refocusing the Agenda for Poverty Eradication’.

Henry Veltmeyer is Professor of International Development, St Mary’s University, Halifax, Canada, and Adjunct Professor, Unidad Posgrado, Ciencia Polític, Universidad Autónoma de Zacatecas, México. He is co-author of, amongst others, *Dynamics of Social Change in Latin America* (Macmillan, 2000) and *Community Economic Development* (Kumarian Press, 2001).
Preface from the Editors of
Development and Change

International development assistance — ‘aid’ — has long occupied a prominent place in debates on development. However, perceptions of its role and significance have changed dramatically over the years. As thoughts and theories about development itself have shifted, so too the role assigned to aid. Whereas for several decades after the end of World War II, the need to provide aid to low income countries in order to stimulate and promote their economic and social development was widely accepted, in recent years both the provision of aid itself, and the question of its role in development, have come under closer scrutiny and have become matters of controversy. The geopolitics of aid, the increasing prominence of aid conditionality, and the reality of aid programmes on the ground, all play a part in this discussion.

In an article entitled ‘Aid as a Catalyst’, published in the September 2001 issue of Development and Change, Jan Pronk argued that:

Aid is not the prime mover of development; it has sometimes even been an impediment, but this need not be the case. To use aid as a reward for good development governance may indeed be justified under certain conditions, but often such conditions can only be met with some outside help. Aid should, therefore, be used primarily as a catalyst, sometimes to help generate other resources or gain access to them, sometimes to help create domestic capacity or manage conflicts resulting from various forms of unsustainable development. At this juncture, what is required is a special focus in aid policy on social harmony, political stability and peace, as preconditions for economic growth and development — not the other way around. (Pronk, 2001: 627–8)

As Editors of Development and Change, we thought that this article, contributed by a prominent exponent who served for thirteen years as the Netherlands’ Minister of Development Co-operation in various cabinets between 1974 and 1998, would be a good point of departure for a revisit to several key issues in the aid debate. We therefore approached a number of commentators, representing different analytical perspectives, with an invitation to reflect upon and respond to Jan Pronk’s article. The reaction was invariably one of keen interest. In the meantime, we also received two independent contributions on the topic, whose authors were also invited to participate in the debate. Finally, Jan Pronk was given the opportunity to respond to the commentators in a rejoinder.

The resulting essays reflect a wide spectrum of theoretical and policy perspectives; in our view, they make an important contribution to a debate which has taken on added salience in the light of developments since
September 2001. Evidently, there is a wide range of opinions and interpretations as to the efficacy of development aid, highlighting the complexity of the issues. While most agree that aid in its present form is not achieving the desired results, this leads to different conclusions and recommendations, from refining the instruments, through reforming the institutions and renegotiating the relationships, to revisiting the whole rationale for development aid.

Demonstrating as they do the relevance and sensitivity of the topic, we felt that the various contributions to this debate — previously scattered across several issues of the journal — deserved to be brought together into a single volume. As one of the contributors to this volume notes, ‘development aid is the repository of accumulated ideas and priorities of development theory of the last sixty years’ (Emmerij, p. 36). We hope that this book will prove a valuable addition to this repository and the debate on this important topic.

The Editors, Development and Change

REFERENCE

Chapter 1

Aid as a Catalyst

Jan P. Pronk

INTRODUCTION

More than fifty years ago, in 1949, President Truman launched his Point Four Programme. This made it ‘the policy of the United States to aid the efforts of economically underdeveloped areas to develop their resources and improve their living conditions’. The launching of the programme is often considered the beginning of international development assistance. After World War II several other countries had already introduced funds to finance development and welfare programmes in their colonies. Immediately after its establishment in 1946, the United Nations too had placed development assistance on its agenda, but funds were limited and the recipient countries were not yet independent. In the early years, priority was given to financing the reconstruction of countries after the war, rather than to investment programmes in developing countries. Reconstruction was also the main aim of the Marshall Plan and the World Bank, both of which were launched in the same period.

After 1949, international technical assistance grew and funds for foreign aid increased. Co-operation between donor countries and aid agencies began to take shape. An aid doctrine developed, reflected in official documents and frequently discussed in the literature. Both economic and political aspects of international assistance were discussed, along with motives, aims and means. As early as August 1945, Jan Tinbergen had written an article in Economisch-Statistische Berichten pleading for worldwide economic co-operation to assist countries with a low standard of living (Tinbergen, 1945). In the Netherlands, Willem Brand and Egbert de Vries followed his lead, while in the United States Walt Rostow, Max Millikan and Edward Mason were amongst the first to take up the topic of aid, not only as researchers, but also as policy advisors. In the 1950s and 1960s,
authors such as P. T. Bauer and Milton Friedman argued against aid, because in their view it could not be effective: while the original objective of aid had been to help countries to develop their own resources, the critics argued that aid would only substitute domestic resources. The debate which followed has resulted in a rich literature on what became known as ‘the economics of aid’, discussing not only motives and objectives, but also effectiveness and impact.

Aid itself has of course changed during this half century. The technical assistance of the early years was followed by community development support in the 1950s, aid to fill trade and investment gaps in the 1960s, aid to provide for basic human needs in the 1970s, assistance to structural adjustment and debt relief in the 1980s, humanitarian assistance in combination with support for rehabilitation of countries after the civil wars of the 1990s and, at the turn of the century, aid for human development, and aid to prevent violent conflicts and to foster democratic governance. To a certain extent these shifts were in answer to altering international relations. Decolonization, the Cold War, the wars in Vietnam, the Middle East and Southern Africa (three areas where the North–South conflict and the East–West conflict coincided), the oil crisis and the world economic recession of the 1970s and 1980s, the end of the Cold War, new internal conflicts, and last but not least, economic and cultural globalization — all these have challenged the motives, aims and character of international development aid.

Changes in aid policy were not only the result of changing circumstances, however. Foreign assistance in the framework of international co-operation was in itself a new phenomenon. The economic and welfare programmes of the colonial period were not a good basis for a development assistance policy aiming at the self-reliance of young nations. Different lessons had to be learned. Solving specific development problems could give rise to new bottlenecks (such as access to markets in order to sustain production increases that had resulted from technical and financial assistance); and these bottlenecks, once recognized, called in turn for new and different approaches. Rendering development assistance was often a matter of learning-by-doing, on the basis of trial and error. In a few cases it involved the breakthrough of a new vision of the concept and process of development itself.

Originally development was seen as a more or less linear process. It was understood that this process would not occur by itself, which led to such theories as the ‘big push’ (Rosenstein-Rodan), the different stages in economic growth (Rostow), the inherently dualistic structure of a developing economy (Arthur Lewis), and the centre–periphery structure of the world economy within which a developing nation had to find its place (Prebisch). There were many different and often conflicting views concerning the importance of domestic versus external factors in national development. Different theories emerged concerning the relationship between economic growth and the distribution of assets and income, reflecting the different weights being
attached to economic and social factors. Even greater divergences arose between theories concerning the relationship between economic and cultural factors.

Thus, development assistance was a process of learning-by-doing, and one which was played out against the background of major changes in international relations. The divergence of views about the process of development itself made the situation even more difficult. Add to this a fundamental lack of knowledge amongst aid agencies about the developing societies concerned, and one should perhaps be surprised to read that aid has achieved any successes at all. And yet this is the message of a recent World Bank report (1998) — that aid has at times been ‘a spectacular success’. The report does issue one important warning, however: aid only works in a good policy environment; it does not work when policies are wrong. If this is true, the success of aid is no less than a miracle, which would surely justify augmenting the current aid effort substantially, and continuing to follow the current policy direction. But is this a legitimate conclusion? Let us first look at this ‘miracle’, and then examine the recipe for its continuation.

A MIRACLE?

That aid could have been a spectacular success despite the four potential pitfalls mentioned above — lack of knowledge about the countries, incomplete understanding of the process, inadequate experience with the instrument, and an ever-changing setting — is quite a miracle, given the different aims pursued by different donors in different periods. There has never been a simple consensus that the sole objective of aid was to sustain the economic development of recipient countries. From the start, aid programmes have been based on three different categories of considerations: charitable, economic and political. Charitable objectives were described in terms of action against hunger, misery and despair. Economic objectives were defined in terms of sustaining the efforts of the populations of the economically underdeveloped countries to develop their resources and to create conditions for self-sustained economic growth. Political objectives were seen in terms of political stability, reducing the potential for conflicts, supporting peace, the promotion of democracy, the preservation of political independence of former colonies and the maintenance of a sphere of influence for Western donor countries.

Not only were there multiple objectives, however: there were also many and varied political motives, all of which played a role in decisions concerning the level of aid, the allocation to countries, the distribution amongst economic and social sectors, the channelling through various public and private agencies (commercial as well as non-governmental) and the choice of partners (governments, the military, international organizations, grassroots movements and others). Moreover, there were many different categories
of aid (grants and loans; financial and technical assistance; project and programme aid; debt creating and debt reducing transfers). Even if it were possible to add these up and relate the total to one overall indicator of progress in a recipient country — such as economic growth — the question remains whether this would have any meaning. Could the resulting ratio be considered an indicator of the effectiveness of aid? Effectiveness of what aid? Measured against which objective? Nor would it make much sense to compare such ratios with each other, either for one country in different periods, or between countries in the same period. The impact of aid would always be time and country-specific, dependent on history, stage of development and international relations.

Despite the differences and possible incompatibilities between their objectives and motives, the overriding view of donors, at least initially, was that aid could help in meeting them all. In 1957 this was characterized in a position paper of the United States House Committee on Foreign Affairs, which justified assistance as follows: ‘The most important reason is that nations are determined to develop. Only by participation in that process will we have an opportunity to direct their development along lines that serve our interests’ (quoted in Ohlin, 1966: 25). This position illustrates three donor motives: to be present in the development process; to steer the development process; to subordinate the development process to the donor’s objectives — or at least, to avoid a clash between donor’s and recipient’s objectives.

There is, however, a difference between believing, on the one hand, that aid in one form or another can help meet different objectives and motives; and, on the other, that there is a direct causal relation between aid and the specific objective of economic growth, whatever the motive of the donor and whatever the background of the recipient. Whilst it might be desirable to be able to measure the effectiveness of aid with a yardstick reflecting a one-to-one relationship between aid and economic growth — or any other overall indicator of development, such as an increase in investment or a decrease in poverty — the methodological difficulties of such a statistical analysis are well known. To measure the effectiveness of aid requires an analysis of the difference between the actual (macro-) economic performance, including aid, and the hypothetical performance in its absence. This is a purely theoretical exercise. Moreover, the outcome of such an analysis does not provide insight into the reasons behind change, or explain why the situation differs before or after aid. Such an analysis cannot attribute changes to aid per se, but can only show that aid has been accompanied by economic growth, a decrease in poverty, or whatever.

Moreover, both the variables involved here — aid and development — are notoriously difficult to define. For instance, the many different forms of aid (such as project and programme aid, commodity aid and import support, debt relief and technical assistance) all have different effects and different time lags. The real value of aid when comparing grants and loans differs and
changes over time. There are different ways to define net and gross aid. Should aid commitments or aid disbursements be chosen as target variables? What constitutes development and who should determine this?

These difficulties can be partially overcome by relating specific forms of aid to specific target variables, such as economic growth or imports or investments in the recipient country. But this does not solve the causality question. Are there other factors which might explain differences in the target variables and which should be incorporated? How are they related to aid? In many developing countries, data are scarce and not reliable. Historical data are often completely absent. This problem can be addressed by using cross-section approaches, but with so much variation between countries, the models used can hardly be expected to reflect all relevant factors in the relations assumed. This applies particularly to differences in the history, culture, geography, size and natural resource endowment between countries. Although a statistical time series analysis of the development process in a specific country is preferable, this too has shortcomings. The development history of the countries concerned is too short, and is characterized by so many shocks — decolonization, revolution, regime changes, wars, droughts and other natural disasters — which cannot be taken into account in a plausible model, that much caution is required in using the results of such a quantitative analysis.

Thus, in-depth qualitative studies of the longer-term development process per country, of all relevant factors playing a role in that process, and their mutual relationships, would provide much better insight than any attempt to find a measurable effect of an isolated factor such as aid. Yet there have been numerous efforts to justify aid by seeking a rational basis for aid decisions with the help of measurable effectiveness criteria. Aid evaluations have been carried out by researchers and by aid agencies in an effort to lay a rational basis under future aid policy decisions. In a survey of evaluation studies, White (1994) concluded that direct regressions between aid and economic growth do not yield meaningful results. A more fruitful approach is to examine the channels through which aid is intended to increase growth, namely by increasing imports and investments and by raising the efficiency of investments.

**THE IMPACT OF AID**

In fact, this had been the approach of the first overall evaluation study of development assistance given by the Netherlands, which was carried out at the request of the Government of the Netherlands, and in which I was involved (see Jansen et al., 1969). The original aim was ambitious: to determine the optimal allocation of a marginal guilder of development aid. A number of different Dutch aid programmes (such as granting fellowships) were evaluated against related objectives (such as strengthening the skill levels in
a country). In addition, a correlation was sought between the economic growth of a country and the total aid received from different sources, including the Netherlands. This was done using a very simple cross-country analysis: there were no time lags assumed; calculations were made with the help of five year averages for the period 1960–64 only.

One of our findings was that, during the period concerned, per capita economic growth had been higher in countries that had received more aid. In about 75 per cent of the recipient countries, between 0.2 per cent and 1.4 per cent of economic growth was ascribed to the aid received. The analysis also led to the conclusion that aid enabled a recipient country not only to finance a higher level of investment but also to improve the productivity of its capital. The latter result was considered of greater importance than the former and led to several policy conclusions, such as giving priority to technical and other assistance in order to increase the capacity of a country to use its capital. The quality of assistance was found to be just as important as the quantity. Aid that would, in one way or another, result in a distortion of the allocation of economic resources of a developing country was to be avoided.

One example of such a distortion is that aid which is intended to finance a specific investment project indirectly binds other investments in the country, for instance in infrastructure and in complementary sectors. The relative merits of project aid versus plan or programme aid have been discussed by a number of authors, including Singer, Little, Clifford, and Chenery, who all come to different conclusions regarding the so-called fungibility of aid. Singer has suggested that ‘the project actually financed by aid may be quite different from the one to which the aid is ostensibly tied’ (Singer, 1967: 539) — the aid would in fact finance the marginal project. Little and Clifford have argued that this would only apply in ‘countries whose governments include development amongst their objectives and have a reasonably clear understanding of development priorities’ (Little and Clifford, 1965: 301). Nowadays we would describe these countries in terms of ‘good governance’. In such countries the high priority project would be financed anyway, plus a new one: together they would be financed out of the sum total of domestic resources and aid. In countries with good governance, fungibility — whether it occurs or not — does not represent a problem. However, Little and Clifford considered these cases to be rare. In countries with bad governance there is only a faint notion of development priorities. Here, the question of fungibility would not even arise, indicating that project aid would be the wiser choice. Chenery, however, argued that well-engineered projects in countries with poorly-run economies would make a low net contribution to development. The necessary redirection of resources towards sectors complementary to the project would either not take place at all or would occur to the detriment of development elsewhere (Chenery, 1967: 9–18). This was an argument against project aid and in favour of general balance of payments assistance. Chenery made clear, however, that
he advocated such assistance only to countries with a good macro-economic policy: the aid had to be provided on the basis of performance of the country concerned.

In the Dutch aid evaluation report (Jansen et al., 1969), it was argued that in case of project assistance, irrespective of the assessment of a country’s overall development policy, finance would not only have to cover the costs of the project itself but also all necessary complementary investments, if distortions of any kind were to be avoided. With the help of the so-called ‘semi-input–output method’ for development programming — which had been developed by Tinbergen (1967) — Pronk and Schreuel (1969) calculated that in the case of India, about 40–60 per cent of total necessary investment (and necessary imports) would be neglected if a project were considered in isolation. This finding could be interpreted as an argument against project assistance to countries with good governance, which should be given balance of payments or programme assistance instead. If project aid was preferred for some reason — such as bad governance in the recipient country — the finding could be seen to support either assistance to bunches of related activities (nowadays known as sectoral assistance), or the combining of project finance with substantial general finance, of about the same order of magnitude as the costs of the project itself. Only by employing one of these strategies could misallocation or distortion of domestic resources (‘indirect fungibility’) be avoided.

CATALYST OR IMPEDIMENT?

Since the mid-1960s numerous, much more sophisticated, evaluation studies have been presented, to provide a rational basis for aid allocation decisions. Towards the end of the decade, Rosenstein-Rodan introduced the concept of aid as a catalyst. In his view ‘aid should be allocated where it will have the maximum catalytic effect in mobilising additional national effort’ (Rosenstein-Rodan, 1969: 1). An evaluation should assess a country’s development effort as a whole, on the basis of three general criteria: ‘the country’s capacity to restructure, its absorptive capacity, defined as its capacity to organise investment in a productive manner and its capacity to mobilise savings, and its capacity to repay’ (ibid.: 9). Chenery and Carter (1973: 459) elaborated on this, describing the analytical and philosophical basis for aid and development programmes as follows:

- external resources can be used by developing countries as a basis for a significant acceleration of investment and growth;
- the maintenance of higher growth rates requires substantial changes in the structure of production and trade;
- external capital can perform a critical role in both resource mobilisation and structural transformation; and
- the need for concessionary aid declines once these structural changes are well under way, although further capital inflow may be productive.
In this analysis, based on the so-called two-gap approach (the savings gap and the trade gap), aid enables a country to increase investment beyond the limit set by the domestic savings rate. According to Chenery and MacEwan (1966: 177): ‘the main function of aid is . . . to permit an economy to grow at a rate determined by its ability to invest rather than by its initial ability to increase savings’. Higher economic growth than would have been possible given the domestic savings rate will lead to higher income and production and increase future savings and exports, making aid less necessary to reach a given target in later years — in other words, aid as a catalyst *pur sang*.

Keith Griffin has criticized the two-gap models developed by Chenery, Strout and others because of their assumption that all aid will result in higher investment. Aid may simply substitute domestic savings, resulting in increased consumption. In that case, aid will not result in higher investment and growth, nor in higher savings. Aid may, according to Griffin, also retard long-run economic growth in many other ways, for instance by altering the composition of investment with a bias towards activities that are not directly productive or have a long gestation period. Aid may have a bias towards capital-intensive technology and a tendency to increase the receiving country’s subsequent need for capital. Aid may frustrate the emergence of an indigenous entrepreneurial class or delay institutional reform, and thus slow down rather than accelerate growth (Griffin and Evans, 1970). Aid then does not function as a catalyst, but, on the contrary, as an impediment.

This is not very different from earlier criticisms by Friedman, who had argued against aid because it would substitute domestic resources. In this view, there is no necessity for aid. If other conditions for economic development are ripe, capital will be readily available through the market; if not, for instance because of inadequate policies of the government concerned, capital made available would be likely to be wasted. A lack of domestic savings reflects a lack of opportunities, not of income (Friedman, 1958).

In response to this, Chenery has argued that in only a minority of cases studied by him, could a parallel reduction in domestic savings be ascribed to inefficiency in transforming aid into increased investment. Only in those cases can one speak of substitution. In a majority of cases there were other constraints, such as a trade constraint. Lack of access to foreign markets, for instance, would render domestic investments less profitable. Moreover, Chenery and Carter (1973) were able to demonstrate that, in general, countries that had raised their savings rate as a result of an aid-supported growth process outnumbered the cases in which an unnecessary diversion to consumption took place. The substitution effect should not be over-estimated. If the marginal propensity to save is greater than the average, higher income will lead to higher savings and aid will result in both higher savings levels and rates. Aid will function as a catalyst, even allowing for a displacement effect.
One may even go a step further and assume that a crowding-in effect takes place rather than a substitution or crowding-out effect. Aid-induced growth may open up new investment opportunities in order to meet an increasing demand for domestically produced goods, in industry as well as in agriculture. An aid-financed infrastructure may enhance the efficiency of production. For large and complex investment schemes private capital is often not available. That is not so much due to inadequate policies of recipient governments, but to a specific risk assessment by the market. Contrary to the assumptions of Friedman and others, markets do not function properly; this applies especially to developing countries, and certainly to international markets when these are not fully accessible for those countries. Capital markets are far from willing to provide capital to a number of priority sectors, such as feeder roads, rural water supply, health and education. Investment in these sectors is necessary not only to increase welfare, but also to accelerate growth. For all these activities aid finance can be seen as vital, as a possible multiplier in order to accelerate development. This is particularly true when financial and technical assistance go together, bringing skills which would not otherwise have been available.

It should not come as a surprise that three decades after Chenery published his findings, Hansen and Tarp came to a similar conclusion (Hansen and Tarp, 2000). They surveyed existing studies on the relation between aid and savings and found that, using a Harrod–Domar framework, only one showed a substitution elasticity of below $\frac{1}{7}$. In all other studies, aid had a positive effect on investment and income.

Two conclusions can be drawn so far. First, the substitution effect of aid may exist, and often does, but it can be dealt with. On balance and in the long run, catalytic crowding-in effects will outweigh fungibility or crowding-out effects. Second, however, this does not imply that if and when such a substitution has been avoided or its effects have been counteracted by good policy-making, a direct causal relationship between aid and economic growth can be considered as proven. It is not possible to argue an unequivocal relationship between aid and a net increment to overall economic growth in developing countries. Results vary per country; there is no general pattern; and for each individual country the correlation varies over time, because of frequent changes in exogenous variables.

It has been argued that the inability of development aid over decades to provide a net increment to overall growth in developing countries provides a case against aid altogether. In my view this is not true. It may be impossible to prove such a causal relation, but — more importantly — this does not mean that aid does not have a positive effect on development, or that it has never had such an impact, or worst of all, that it never could have such an effect, as seems to be the current wisdom of aid-watchers looking back at fifty years of development aid so far. On the contrary, if aid were conceived not as a direct cause of development, nor as its origin, its source or its prime
mover, but only as a catalyst, many studies of the impact of aid could have been left undone or replaced by less abstract analyses. Expectations concerning the results of aid could have been toned down and made more realistic. It is surely preferable to look at specific forms of aid, in specific circumstances, to specific countries, in order to reach specific objectives. These are the only aid evaluations that make sense. For it is only in the light of lessons learned from concrete experiences, studied with the help of an analytical framework and taking all relevant factors into account, that a rational basis can be found for future aid allocation decisions in more or less similar situations.

GOOD POLICY

In fact, quality is the only thing that matters, whether we are talking about the quality of aid or the quality of a recipient’s policy. Much aid has failed, but country- and sector-specific studies show that where quality conditions are met by both the donor and the recipient, ‘good aid’ does result in a decrease in poverty, reflected for instance in improved rural development, reduced infant mortality or greater access to primary education (see, for instance, Cassen, 1994).

In trying to attain this quality, good donor governance is essential. Aid itself should not create distortions, nor should it result in a foreign debt that might never be financed out of the increased income attributable to aid. With this in mind, we can begin to assemble a set of criteria for ‘good aid’. Aid should mainly consist of grants. It should be adapted to the technical and institutional capacity of the recipient. It should be compatible with the culture of the country concerned. It should be demand-driven rather than supply-driven. It should cover additional, current and complementary costs as long as these cannot be financed from increased domestic income. It should not replace domestic skills or entrepreneurship by introducing a bias in favour of foreign expertise or networks. It should not result in a distortion of salary scales and consumption patterns, or a brain drain, which the recipient country could not afford — bad aid can decrease rather than increase the productivity of the domestic resources already available within the country itself. Last but not least, aid should be accompanied by policies within donor countries to open their markets for the goods and services produced as a result of aid.

All this is good governance on the side of donors. It should accompany good governance on the side of recipients in order to render aid effective. One might even say that good donor governance should set an example, without which good governance in developing countries has even less chance of sustainability. Good foreign governance may have to precede good domestic governance. Aid could thus become a catalyst not only for economic growth, but also in terms of furthering good policy-making, with future
aid being made conditional on the implementation of good policies in the developing country itself. While this approach seems attractive, however, it has limitations. The questions arise: what is a good policy and who is to be the judge of that? The donor agency, the recipient government, or the people of the country concerned, the intended ultimate beneficiaries of aid? And, even more difficult, what happens when the donor decides that the recipient’s policy or governance is not good enough?

This last question drew much attention during the debate on structural adjustment in developing countries in the 1980s. Policy reforms were considered necessary in order to stabilize the economy as a precondition for economic growth. Aid agencies, led by the International Monetary Fund and the World Bank, made aid conditional on the implementation of such reforms, and many bilateral donors followed the same course. This prompted an interest in analysing the effect not only of policy adjustment on stability and growth, but also of external finance for such adjustment programmes on these policies. The impacts of adjustment policies, and thus indirectly of adjustment assistance, have been analysed in terms of stability indicators (such as budgetary deficits or inflation) as well as indicators of subsequent economic growth and poverty reduction, both during and after a period of adjustment.

The debate on structural adjustment and its impact has been quite sharp. The findings have diverged widely, depending on the country or sector studied. However, some common features of the findings have gradually emerged, and can be summarized as follows (see for instance, World Bank, 1994):

- policy stance is a vital factor in economic reform;
- there is a positive impact of economic reform (structural adjustment) on growth, but reform plus aid is superior to either one of them alone — there is an increased combined effect;
- there is no clear relationship between change in aid and policy change; increases in aid do not necessarily forestall or retard reform, while decreases may lead some countries to improve their policies.

In other words: aid cannot buy policies; policies have a greater impact than aid, but together they have a greater impact than either one alone; and this combined effect is greater than the sum of the two isolated effects. Analytically this is a little puzzling, but in terms of aid policy-making it is helpful, because it highlights once again the functioning of aid as a catalyst.

Some light has been thrown on this by Lensink (1993), in a study on the impact of aid to sub-Saharan countries in the 1980s. Lensink concluded that the positive impact of aid on economic growth was counteracted by government behaviour, since in response to aid, governments relaxed their efforts or increased their unproductive consumption expenditure. This could explain the so-called micro–macro paradox: that even where aid projects are successful,