



## *International factors in reducing poverty*

Although domestic policies are the essential ingredients of a strategy for reducing poverty, international factors play an important part. This chapter discusses world trade, international debt, and the supply of foreign aid to developing countries. In each case it asks what the implications are for the poor.

### **Trade and poverty**

Trade performance and prospects differ greatly among developing countries. Some middle-income countries have a diversified production base and substantial manufacturing and exports. The newly industrializing economies of East Asia are the most obvious examples, and a number of Latin American countries also fit into this category. Most of these economies, especially those in East Asia, have made substantial headway in reducing poverty. Other middle- and low-income countries have an increasingly diversified economic base but have not yet attained such high levels of development. They include the emerging “second tier” of newly industrializing economies—notably Indonesia, Malaysia, and Thailand—and some low-income countries such as China and India. Many of these, too, have reduced poverty dramatically over the past two decades. Still other countries, including many in Sub-Saharan Africa, produce and export mainly primary commodities and lack a diversified economic base. Very few of them have had much success in reducing poverty.

Given this pattern of trade and poverty, the effects on the poor of changes in international trade relations are likely to differ according to country characteristics. The domestic policies of the devel-

oping countries themselves—for example, regarding exchange rates, levels of protection, and other interventions—are largely responsible for the countries’ success or failure in world trade. They also have direct and indirect effects on poverty. These and other policies are discussed elsewhere in this Report. This chapter addresses some of the ways in which industrial country trade policies affect the poor in developing countries.

### *Industrial country protectionism*

The developing countries face many obstacles in selling their products abroad. High on the list are the *farm trade policies* of the industrial countries. In OECD countries assistance to farmers through price supports, direct payments, and supply management programs seriously distorts world trade in agricultural commodities. On the whole, these policies raise domestic farm production, leading to more exports, fewer imports, and lower world prices. Price decreases help those developing countries that import the commodities concerned, but they hurt those that are themselves net producers (and are often more efficient producers than their industrial country counterparts).

*Nontariff barriers* also thwart some agricultural exports from developing countries to OECD markets. Quantitative import restrictions most frequently affect sugar and animal and dairy products, but processed fruits, groundnuts, tobacco, and rice are also common targets. About one-third of the agricultural exports of developing countries appear to be affected by such barriers. The effects can be serious (Box 8.1).

*Tariff escalation* has a particularly damaging effect

### Box 8.1 Industrial country trade policy and the poor in the Dominican Republic

The Dominican Republic demonstrates vividly the impact that industrial countries' trade policies can have on the poor in developing countries. One U.S. trade policy—its sugar import quota—has greatly harmed the country's rural poor, whereas its "807 program," which encourages assembly operations using materials imported from the United States, has apparently helped to generate urban employment.

The U.S. sugar import quota varies with domestic production, but it is largely determined by political interests. The total import quota for all exporting countries was reduced by about 70 percent between 1982 and 1987. The Dominican Republic, which traditionally has had the largest national allocation, saw its quota reduced proportionately. During the same period the European Community (EC), the world's largest sugar exporter, continued to export more than six million tons of sugar a year. The combination of a shrinking preferential U.S. quota and booming, subsidized EC exports wreaked havoc on the world sugar market. Throughout the 1980s the world price was only about one-third of the U.S. protected price. The Dominican Republic is one of the world's more efficient producers of cane sugar, yet it found itself unable to compete at the unprecedentedly depressed world price. At the same time, its access to the U.S. preferential market was shrinking. Its only recourse was to cut sugar production and exports drastically. Four sugar mills were closed by 1990, and production plunged 40 percent following the reduction in the quota.

Since sugar is the main rural economic activity in the Dominican Republic, the repercussions were severe. The average real incomes of cane workers—who were already among the lowest-paid people in the rural economy—collapsed. About two-fifths of the estimated 50,000 expatriate Haitian cancutters lost their jobs, together with perhaps half of their Dominican counterparts. Although most mill employees of the Dominican

state sugar company kept their jobs, the field workers had to fall back on subsistence farming, compete for meager wages in the depressed day labor market, or migrate to the towns.

U.S. sugar policy is not, of course, the sole determinant of rural poverty in the Dominican Republic, but it has certainly made development much more difficult. The country's real per capita income has stagnated since the early 1980s, and rural per capita income has fallen by as much as 40 percent. Infant mortality and malnutrition rates, particularly in rural areas, are closer to those prevailing in neighboring Haiti—the poorest country in the Western Hemisphere—than to the average for Latin America. This is in spite of the fact that the per capita GNP of the Dominican Republic is almost equal to the Latin American average.

In sharp contrast, the U.S. 807 program has helped the economy. If an import under the program is assembled from U.S. material (an example would be shirts sewn from U.S. cloth), tariffs are levied only on the value added by the exporter. Since 1980 the number of firms in export processing zones (EPZs), which mainly assemble U.S.-produced parts, has risen from 70 to 330. The firms now account for about half of all manufacturing employment and have since 1980 generated the bulk of the nation's incremental merchandise exports. Employment in EPZ firms—which mainly use semiskilled workers—has increased from 16,000 to 130,000. Since 1980 such firms—stimulated by the U.S. 807 program—have provided one-fifth of the urban jobs created in the Dominican Republic.

U.S. trade policy has substantially altered the shape of the Dominican economy. EPZ exports have replaced sugar as the country's largest foreign exchange generator. Although some new higher-paying jobs have been created for the urban poor, the net effect of the policies has been increased impoverishment in the Dominican Republic.

on low-income countries. Industrial countries' tariff duties generally increase—or "escalate"—according to the degree of processing. The purpose of this protection is to retain high value added processing in the developed countries. Products for which escalation is most pronounced include tobacco, rubber, leather, paper, cotton, jute, and iron. Average industrial country tariffs on fruit preparations are double the tariffs on fresh fruit; tariffs on vegetable preparations are more than double those on fresh vegetables. Escalation discourages the processing of commodities in developing countries. More than 70 percent of developing countries' meat, fish, and vegetable exports

are in the primary stage; more than 90 percent of their cocoa and sugar exports are unprocessed. The amount of labor used in processing varies from product to product, but many such activities would be labor-intensive, and low-income countries could have a comparative advantage in them.

Industrial country trade restrictions concerning *textiles and clothing* are another example of how protectionism can hurt low-income countries. Exports of these products by developing countries amount to \$30 billion. Much of the world's trade in textiles and clothing is governed by the Multifibre Arrangement, which sets bilaterally negotiated quotas designed to slow the growth of exports

from low-cost (mainly developing country) producers (Box 8.2).

The industrial countries have put in place a number of special arrangements with the avowed purpose of stimulating exports from developing countries. The main such arrangement is the generalized system of preferences. With some exceptions, these schemes have done little to offset the damage done by the much broader range of overtly protectionist devices. The benefits from such preferences have been mainly concentrated in a handful of middle-income countries with relatively few poor people (Box 8.3).

*Assessing the effects of trade liberalization on developing countries*

Developing countries will reap substantial gains from trade liberalization by the industrial countries. It is difficult, however, to make a precise calculation of these benefits. Results would vary from country to country, and many countries would gain only over the long-term. Table 8.1 presents the results for selected developing countries of a simulation exercise showing the short-run changes in exports if trade were completely liberalized.

**Table 8.1 The effect of complete trade liberalization on selected countries**

<i>Economy</i>	<i>Change in exports (percent)<sup>a</sup></i>	<i>GNP per capita 1987 (dollars)</i>
<i>High and middle income</i>		
Hong Kong	25.9	8,180
Korea, Rep. of	21.6	2,900
Yugoslavia	14.0	2,480
Dominican Rep.	13.0	740
Tunisia	11.4	1,190
Mauritius	10.5	1,500
Thailand	10.3	850
Morocco	8.9	620
Singapore	7.2	8,010
Brazil	6.8	2,030
<i>Low income</i>		
Sri Lanka	20.9	410
China	13.0	300
Pakistan	10.7	340
Haiti	9.3	360
India	8.6	310
Bangladesh	-1.0	160
Tanzania	-3.3	210
Burundi	-5.5	250
Nepal	-9.6	160
Somalia	-24.3	170

a. Percentage change in value of exports in 1983 attributable to full trade liberalization.

Source: Karsenty and Laird 1987 and World Bank data.

**Box 8.2 Bangladesh is not spared from MFA quotas**

The emergence of an export-oriented garment industry in Bangladesh—one of the world's poorest countries, with a GNP per capita of only \$170 and with 57 percent of its population in poverty—was a great success in the early 1980s. Quota restrictions on Korea's textile exports under the Multifibre Arrangement led Korean exporters to look elsewhere for trade opportunities, and a Korean joint venture was a catalyst in building up an efficient industry in Bangladesh. By the end of 1985 there were about 700 garment factories in the country. From a negligible start around 1980 Bangladesh's garment exports rose to more than \$100 million in a couple of years. The garment industry provided employment for many poor people, mostly women. The production and export of garments is a clear example of the kind of efficient labor-intensive activity advocated in this Report.

In 1985 Canada, the United States, and some European countries—notably the United Kingdom and France—imposed export quotas on Bangladeshi garments. About 80 percent of Bangladesh's garment exports were going to the United States at that time, yet their share in total U.S. imports of clothing and textile products was less than 0.5 percent. The initial U.S.

quotas covered only two product groups: cotton coats and men's and boys' shirts. Seven additional groups were brought under quotas in 1986. By 1987 there were thirteen quotas.

Initially, with stocks of garments building up in warehouses, on docks, and aboard ships in U.S. ports, the quotas had a big effect in Bangladesh. Many factories closed. The United States later increased its quotas, and exporters in Bangladesh managed to diversify their markets as well as their products. In 1987 Bangladesh exported over \$300 million in thirty-five garment categories, including products made of cotton, wool, and man-made fabrics. These products accounted for nearly 30 percent of the country's exports.

The story does not appear to be over. In 1988 most of Bangladesh's clothing and textile products subject to quotas in the United States were again reaching their quota limits: the overall quota utilization rate was more than 90 percent. The dismantling of the Multifibre Arrangement would reduce the instability in Bangladesh's most important industry, permit the country to fulfill its great potential as a garment exporter, and lead to substantial employment gains for poor workers in the industry.

### Box 8.3 The generalized system of preferences: who benefits and how much?

The generalized system of preferences (GSP) is complex. Each industrial country in the scheme—including the United States, Japan, and the members of the European Community—grants its own preferences, and there is considerable variation among them. Most schemes are limited to manufactured exports, but a few cover relatively small quantities of agricultural products. Some donors charge no duties at all on specified products from qualifying countries, and others have duties but at a preferential rate; the least-developed countries are usually given a zero rate.

Most studies agree that the GSP does little to increase trade. It has been estimated that total imports in most preference-granting countries are less than 0.5 percent higher as a result of the system. In the beneficiary countries the effects are generally about 1 or 2 percent of total exports, with important exceptions. The most exhaustive effort to assess the direct trade effects of all the GSP schemes concluded that in 1983 about \$6.5 billion of the imports by GSP donors from the preference-receiving countries could be attributed to the various schemes. This represented just 2.3 percent of total imports, which amounted to \$280.6 billion.

The gains, with a few exceptions, have been concentrated in a few middle-income economies, particularly Hong Kong, Korea, and Taiwan, China. These econo-

mies have received an estimated 44 percent of the total benefit; each gains three times more than the next largest beneficiary, Brazil.

An assessment of the GSP found that of the thirty principal beneficiaries, only four—Bangladesh, China, Haiti, and India—were low-income countries. Except for Haiti, incremental exports attributable to the GSP were tiny.

An effort to work out what the effects would be if GSP schemes were extended without any limitation on product or country coverage found that imports by donors from preference-receivers would increase by about \$20.7 billion. But the poorest countries would actually face some loss of trade because they currently enjoy better treatment than other GSP beneficiaries in most markets. The same would also be true of some beneficiaries under the Lomé Convention, a system of trade preferences granted by the EC.

The various GSP schemes may have helped some poor people in the middle-income countries to the extent that the expanded exports were labor-intensive in production, but the poor in low-income countries cannot have gained much at all. The clear tendency to exclude agricultural products from the schemes strengthens this conclusion.

In general, the successful middle-income exporters, which have relatively little poverty, would benefit. The outcome would also be positive for some low-income countries, including those with the largest numbers of poor people, China and India. But for many low-income countries—mainly but not exclusively in Sub-Saharan Africa and mainly exporters of primary products—any benefits from industrial country liberalization would be slow to materialize. Several countries might actually lose in the short run from complete trade liberalization because their existing trade preferences would disappear. Moreover, net food importers would suffer some losses because liberalized trade in agricultural goods would probably raise world food prices.

Much depends on the commodity composition of exports (Figure 8.1). Countries that produce and export mainly primary commodities, such as the low-income African countries, could not be expected to profit much from liberalization in the short run. Tariffs are already low or nonexistent on most such commodities, demand in the importing countries is often insensitive to price, and existing

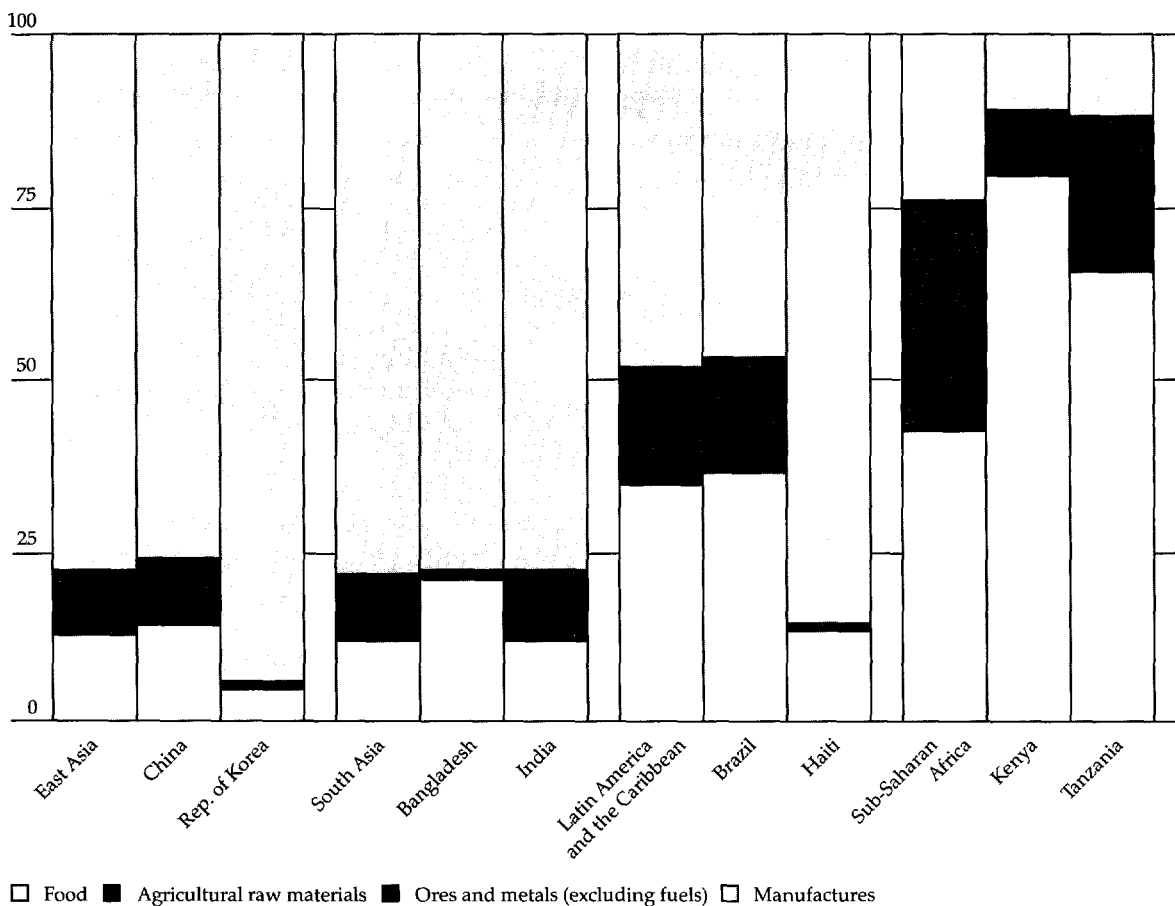
preferences would be lost. Many countries produce few of the goods that might experience a rise in demand as a result of tariff cutting in the Uruguay Round or other forums. And the low-income countries suffer from structural rigidities that make them slow to adopt new patterns of production and exports.

Despite this, industrial country liberalization should continue to be the goal. It would have the following favorable effects.

- Poor people in middle-income countries—who number about 175 million—would probably gain, since many of the exports, especially manufactured exports, that would be stimulated by liberalization are labor-intensive.

- In some sectors, notably textiles and clothing, low-income as well as middle-income countries would be likely to benefit immediately from liberalization. If all bilateral quotas and tariffs under the Multifibre Arrangement were removed, developing countries would realize an estimated benefit of \$11.3 billion, or more than one-third of their total exports of clothing and textiles. The expansion of trade brought about by abolition of the Multifibre

**Figure 8.1 Commodity composition of exports, 1988**  
(percentage of total value in dollars)



Note: The data for Sub-Saharan Africa do not include Botswana and Lesotho.  
Source: United Nations Statistical Office.

Arrangement might raise employment in these countries' textile and clothing industries by 20 to 45 percent. China might gain about \$2.3 billion and Bangladesh about \$340 million (or 44 percent of its total exports in 1986).

- Trade liberalization would have longer-term effects that would eventually benefit even the low-income countries that are largely dependent on primary commodities. But this would depend on whether these countries adopted policies that would encourage a supply response. If tariff escalation could be substantially reduced, for example, it would be easier to diversify away from primary commodities. One study found that the removal of all industrial country tariffs on processing would increase such activities in developing countries by

almost 80 percent in the case of coffee, 76 percent for wool, and 52 percent for cocoa.

In the end the gains for the poor could be large. But the diversification required in many countries cannot take place overnight. It will take time for the poorest countries to reorient their production and export bases to take advantage of the more liberal trade environment that might emerge from the current round of multilateral trade negotiations. Policy and institutional reforms will be required. These efforts will call for substantial investment, and in the years ahead this is bound to be difficult. External assistance, including debt relief and the provision of concessional finance, will thus have a significant role in these countries for at least the next decade.

## Debt and poverty

Limited export earnings are likely to be an important constraint on the development prospects of many countries. Debt burdens are another problem. There are twenty-six severely indebted low-income countries, of which twenty-four are in Sub-Saharan Africa, and nineteen severely indebted middle-income countries. Chapter 1 discussed the debt problems of the second group of countries and the international initiatives for dealing with them. This chapter focuses on the debt burdens of low-income countries.

In absolute terms the debt of the severely indebted low-income countries—\$103 billion in 1988—is not high compared with the \$516 billion owed by the middle-income group. But some indicators of debt burden are actually much higher for the first group. The ratio of debt to GNP for the low-income countries, for example, was 111 percent in 1988; for the middle-income countries it was 54 percent.

A number of international initiatives for dealing with the debt burdens of low-income countries have been undertaken. Since 1978 many bilateral donors have converted part of the official debt owed by these countries into grants. It is estimated that \$3 billion of official debt has been canceled in this way; about \$2 billion represented claims on low-income Sub-Saharan African countries. Although this is an important achievement, the canceled debt amounts to only about 3 percent of the total outstanding debt of the low-income African countries at the end of 1988. Moreover, many of these countries will not benefit greatly from further conversions of loans to grants, since most of their concessional loans have already been forgiven.

The agreement reached at the Toronto economic summit in June 1988 provides debt relief on official bilateral nonconcessional debt under the auspices of the Paris Club for severely indebted low-income countries that are undertaking adjustment programs. As of March 1, 1990, the "menu" of options agreed on at Toronto (partial write-offs, longer repayment periods, and more concessional interest rates) had been applied to sixteen Sub-Saharan African countries. The Toronto accords were a breakthrough in dealing with the debt of low-income countries because they officially sanctioned the principle of debt relief. It was acknowledged that these countries could not simply "grow out of debt."

As with the conversions of concessional loans to grants, however, the amount of actual debt relief delivered by the Toronto accords is limited so far. The cash flow savings for twelve Sub-Saharan African countries participating in the Special Program of Assistance in 1989 were about \$50 million (in relation to rescheduling under standard terms), or 2 percent of their debt service.

Projections indicate that Toronto-terms reschedulings are likely to have only a small effect on the future stock of debt. If there is no change in the debt-relief options offered by creditors and if Toronto terms are applied repeatedly (that is, if rescheduled debts coming due are again rescheduled on the same terms), the total reduction of debt to all bilateral creditors by the end of 2000 would be about \$2.0 billion, or only 11 percent of long-term nonconcessional debt in 1988.

In 1988 interest payments on the external debt of the low-income countries of Sub-Saharan Africa (including Nigeria) totaled about \$2.9 billion. This represented about 27 percent of net disbursements of all official development assistance (ODA) to these countries in that year. The ratio of interest payments to pure grants was more substantial—it was 47 percent in Kenya, 52 percent in Ghana, 50 percent in Madagascar, 73 percent in Togo, and 57 percent in Zaire. Such high levels of interest payments severely limit the contributions that aid can make to increasing consumption and investment and reducing poverty.

A number of other low-income countries have had increasing recourse to nonconcessional borrowing as a result of stagnation in aid flows. For example, over the past decade India's ratio of debt service to exports has increased from less than 10 percent to about 30 percent. In 1988 its interest payments on external debt actually exceeded net disbursements of ODA (interest payments were \$3.1 billion and net disbursements were \$2.1 billion). Pakistan's debt service is about 25 percent of exports. In 1988 interest payments on external debt were about 45 percent of the net disbursements of ODA that it received. If India, Pakistan, and a number of other non-African low-income countries are to avoid the fate of the severely indebted low-income countries, they will clearly need to boost exports substantially. But they will also require continued substantial inflows of external assistance on concessional terms.

Many low-income countries—especially but not exclusively in Sub-Saharan Africa—find themselves with daunting debt and debt service bur-

dens at a time when they need to invest more (in order to improve their long-term prospects) and, simultaneously, to increase the consumption of large numbers of people in poverty. Further efforts by the international community will be needed to reduce their debts and to increase concessional assistance to them. These efforts should be conditional on appropriate policy reform in the countries concerned. Aid and debt relief will be of no avail if appropriate policies are not in place.

### Aid and poverty

Official development assistance in 1988 was \$51 billion—half the net receipts of external capital by developing countries. For the low-income countries, where most of the world's poor live, aid represents close to 70 percent of net external finance. In many of these countries aid is a much more important source of foreign exchange than are exports (Table 8.2). Given the scale of this effort, it is important to assess the effectiveness of external assistance and to learn from past successes and failures. Aid donors have increasingly recognized this and have been modifying their policies—through improved coordination, for example—to take account of the lessons of experience.

Although many countries have benefited significantly from aid, some of the poorest countries have become trapped in "aid dependency." They

need aid just to maintain their present low quality of life, when it should go toward improving their long-term prospects. Viewed from the perspective of this Report, another fact about aid is particularly worrying: in many countries aid has done much less than might have been hoped to reduce poverty. In its comprehensive review *Twenty-Five Years of Development Cooperation*, which covers the period 1960–85, the OECD's Development Assistance Committee (DAC) concluded that "the most troubling shortcoming of development aid has been its limited measurable contribution to the reduction—as distinguished from the relief—of extreme poverty, especially in the rural areas of both middle-income and poor countries."

This part of the Report asks why aid has apparently been less effective than it might have been in reducing poverty and examines how future programs can be strengthened and improved. It notes that much aid—especially bilateral aid—has simply not been concerned with economic development or poverty reduction and that although aid specifically devoted to these objectives has had many clear successes, there have also been some problems.

#### *The motives for supplying aid*

Aid is provided by three broad groups of donors: bilateral donors, multilateral agencies, and non-governmental organizations. Their respective shares in the total aid receipts of developing countries are shown in Figure 8.2. Box 8.4 discusses some characteristics of the aid they provide.

Bilateral donors, in particular, provide aid for many reasons—political, strategic, commercial, and humanitarian. Reducing poverty is only one motive, and it is usually far from the most important. This has several results.

- Not all aid goes to low-income countries. In 1988 about 41 percent of it was directed to middle- and high-income countries.

- There are great disparities in the per capita allocation of aid, and the most generous per capita allocations do not necessarily go to the poorest countries (see Table 8.3). Despite their poverty, China and India have received almost the least aid per capita.

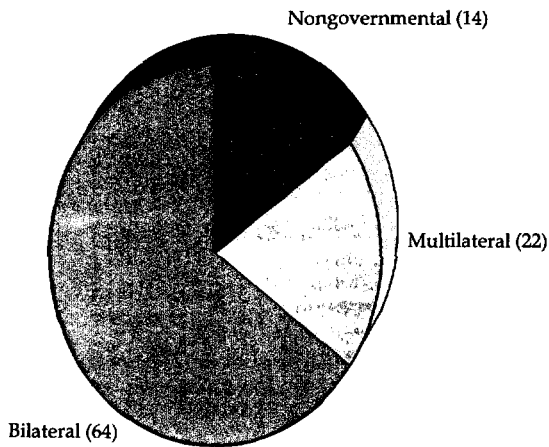
- Many "aid" programs in donor countries cover an assortment of activities (including commercial and strategic initiatives) which often have, at best, a tenuous connection with development. Only about 8 percent of the U.S. aid program in 1986, for example, could be identified as "develop-

**Table 8.2 The relative importance of aid in selected developing countries, 1987**

Country	Total aid receipts as a percentage of GNP	Aid receipts from DAC countries as a percentage of exports to OECD markets
Guinea-Bissau	89.3	956.0
Gambia, The	55.6	89.1
Mozambique	51.7	509.2
Chad	28.3	332.2
Malawi	23.6	61.0
Zambia	22.5	53.0
Tanzania	17.0	270.4
Lesotho	15.6	1,041.7
Bangladesh	9.4	105.9
Benin	7.9	108.5
Sierra Leone	7.6	26.4
Kenya	7.5	60.3
Myanmar	3.6	261.6
Pakistan	2.7	18.2
Indonesia	1.9	7.7
India	0.7	11.8
China	0.5	3.9

Source: Organisation for Economic Co-operation and Development 1990.

**Figure 8.2 Sources of developing countries' net aid receipts, 1987**  
(percent)



Note: The total amount of aid receipts was \$40.3 billion. The amount received from nongovernmental organizations was \$5.5 billion, of which \$2.2 billion represented funds that these organizations received from official aid agencies and transferred to developing countries.

Source: Organisation for Economic Co-operation and Development 1989 and 1990.

ment assistance devoted to low-income countries."

- A substantial amount of bilateral aid is "tied"; recipients are required to buy goods and services from donor countries. Approximately two-thirds of all aid supplied by DAC members is in this category.

- Donors prefer to finance physical capital installations that help their own firms and exporters, and they are reluctant to support the operating ("recurrent") costs of aid-funded undertakings. But many of the initiatives required for reducing poverty in the developing world are in sectors such as health and education that make intensive use of recurrent resources.

In sum, a substantial proportion of aid is provided at least partly for purposes other than to promote development. It stands to reason, therefore, that the impact of aid on poverty has been smaller than it might have been.

#### *Aid for development*

When aid has served development, it has done so in two main ways: by providing general budgetary

support to countries with balance of payments difficulties and by financing development projects in specific sectors. How far has aid of this sort helped to reduce poverty?

A clear link between aid and the reduction of poverty has been hard to find. The main reason is that aid is only one of many factors influencing poverty and is often far from the most important. Domestic policies, the institutional and managerial capacity of the recipients, and other variables often matter more. Although the overall effects of aid may be unclear, detailed studies of individual countries have highlighted its role in specific instances.

Aid contributed in an important way to growth and declining poverty in Korea, for example. A recent study concluded that aid-financed investments in infrastructure paved the way for the country's successful export-oriented growth in the 1960s, that assistance to education was vital to the development of a literate labor force, and that aid promoted agricultural and rural development.

Korea has moved from an initial heavy dependence on aid toward self-reliance. In the 1950s concessional assistance financed about 70 percent of total imports and accounted for more than 75 percent of all savings. Later, external support from official nonconcessional sources increased; Korea has received a cumulative total of \$7 billion in such assistance from the World Bank. The country now receives substantial volumes of private capital from commercial sources.

**Table 8.3 Per capita aid receipts, 1988**  
(dollars)

Country	Aid receipts per capita	GNP per capita
Israel	282.07	8,650
Jordan	108.95	1,500
Gambia, The	102.63	200
Senegal	78.85	650
Zambia	63.73	290
Egypt	29.91	660
Nepal	22.05	180
Ethiopia	21.05	120
Syrian Arab Republic	16.34	1,680
Bangladesh	14.62	170
Pakistan	13.32	350
Myanmar	11.22	... <sup>a</sup>
Indonesia	9.34	440
India	2.58	340
China	1.84	330
Nigeria	1.09	290

a. GNP per capita estimated at less than \$500.

Source: Organisation for Economic Co-operation and Development 1990 and World Bank data.



### Box 8.4 Foreign aid for development

Official aid is disbursed to recipient countries from bilateral and multilateral sources. It comprises grants and loans (with at least a 25 percent grant element) from official sources that have promotion of economic development and welfare as their main objectives. In addition, a great many nongovernmental organizations in industrial countries also provide aid. Measures of aid effort differ considerably depending on the figures used. Among DAC members, the United States is the largest donor in terms of total volume; it provided \$10.1 billion in aid in 1988. Japan, with \$9.1 billion, was the next largest provider of total aid. But the United States is near the bottom among DAC donors when aid is calculated as a proportion of GNP—the figure is only 0.21 percent. At the other extreme, Norway gives 1.10 percent of GNP. Aid from Arab countries in 1988 totaled \$2.3 billion, of which \$2.1 billion was from Saudi Arabia and \$108 million from Kuwait. Saudi Arabia's ratio of aid to GNP was 2.70, the highest for any donor, and Kuwait's was 0.41, above the average for DAC members (Box figure 8.4).

U.S. aid is mainly directed to countries of key strategic importance such as Egypt and Israel; French and British aid goes disproportionately to former colonies. Some donors—the Nordic countries, for example—have emphasized the reduction of poverty more than others.

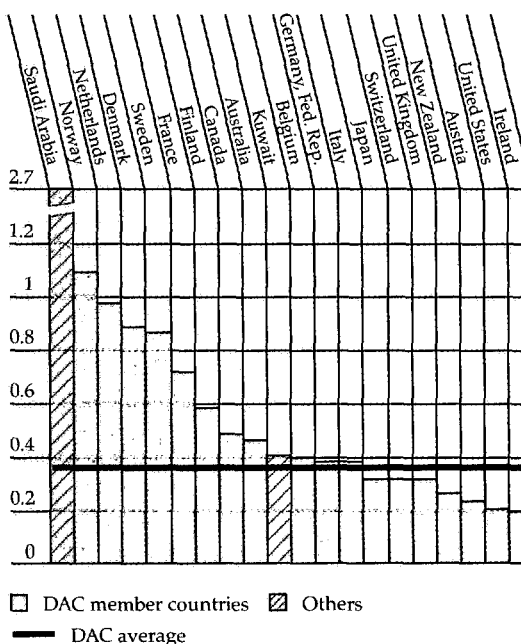
Multilateral aid is provided by two main categories of suppliers: the multilateral development banks and the functional agencies of the United Nations system. Net disbursements of concessional assistance from the multilateral development banks totaled about \$5 billion in 1988; of this, assistance from IDA accounted for about \$3.8 billion. The United Nations assistance agencies, such as the United Nations Children's Fund, the United Nations Development Programme, and the World Food Programme, provided about \$3.8 billion.

Nongovernmental organizations in industrial countries supplied about \$5.5 billion in financial resources to developing countries in 1987. In addition, they are extremely important in educating the public on development issues.

Bilateral donors are frequently criticized for providing aid for political, strategic, and commercial reasons. But they are able to focus on countries or sectors in

which they have particular experience and expertise, and they are often responsible for novel or innovative approaches. Multilateral agencies generally give more weight to developmental criteria, and some play a leading role in the policy dialogue with recipients and in the aid coordination process. But many regard these agencies' approach as excessively technocratic, and the conditionality attached to assistance from the development banks is often a bone of contention. Nongovernmental organizations are particularly adept at local interventions, participatory approaches, and poverty reduction. But they are small, and many have questioned whether they are capable of providing large-scale delivery of services on a sustained basis.

Box figure 8.4 Aid as a percentage of GNP, 1988



Source: Organisation for Economic Co-operation and Development 1989.

A number of other countries have moved toward self-reliance, and most of them have also made good progress on poverty. Indonesia, where the headcount index of poverty fell from 58 to 17 percent between 1970 and 1987, is a good example. During that time it received more than \$12.9 billion in foreign aid, making it the seventh largest aid recipient. Between 1968 and 1974 all World Bank

lending to Indonesia was concessional and was extended through the International Development Association (IDA). Virtually all Bank lending to Indonesia since then has been in the form of nonconcessional loans. The country advanced partly because of its newfound oil wealth, which the authorities managed very well. Nevertheless, there is general agreement that without aid—for

agriculture, education, and family planning, for example—the country's efforts to develop and thus to reduce poverty would have made slower progress.

The story is different in other countries—Tanzania, for example. Tanzania's GDP, which had grown by more than 6 percent a year in the immediate postindependence years (1961–67), increased 4.3 percent a year during 1967–73, 2.5 percent during 1973–79, and less than 1.4 percent during 1979–85. All the while, aid poured in. Between 1970 and 1988 the country received about \$8.6 billion in concessional assistance.

Tanzania's espousal of African socialism, with its stress on equity and the fight against poverty, appealed greatly to bilateral and multilateral donors. The country's development strategy was based on cooperative "villagization" in agriculture, the provision of health, education, and water to the rural poor, and a headlong drive toward industrialization. But the economywide policies pursued were frequently ineffective; they actually discouraged agriculture and supported large, inefficient state enterprises. The public sector took on a greater role in every aspect of the economy, contributing to severe policy distortions and misallocation of resources. This combination of policies meant that Tanzania's aid-financed initiatives largely failed. Per capita real private consumption has fallen by 43 percent since 1973, and poverty has increased. Whereas Korea and other aid recipients greatly reduced their reliance on aid, Tanzania came to depend on it increasingly. In recent years, however, Tanzania has undertaken significant institutional and policy reforms, and the World Bank and other donors have provided support for these efforts.

Other aid recipients have also traveled the road toward aid dependency. Sudan received about \$9.6 billion in foreign aid during 1970–88, making it the ninth largest aid recipient in absolute terms; Zaire received \$5.8 billion over the same period. Neither has made much headway on growth or poverty. Mozambique, Niger, Togo, and Zambia are similar cases. Outside Africa, Haiti has also received substantial aid and yet has failed to reduce poverty.

One lesson stands out from this picture: success and failure in aid programs spring from the actions of both donors and recipients. When countries have adopted domestic policies that use aid effectively, and when donors have backed good advice with assistance aimed at overcoming development bottlenecks, the result has been a virtuous circle of growth and diminishing dependence on aid. But

aid recipients have often followed policies that were harmful to both growth and poverty reduction, and donors have not always monitored programs carefully or linked assistance to policy reform.

### *Projects and poverty*

A large part of the aid that flows to poor developing countries finances specific projects. Again, the effect of aid on the poor is difficult to judge. One reason is that sometimes external assistance for specific antipoverty projects indirectly finances other undertakings that may not help the poor and may even hurt them. Nevertheless, observers have generally concluded that projects in at least the following areas have reduced poverty: agricultural research (particularly on crops grown predominantly by the poor) and extension; the introduction of high-yielding varieties of foodgrains in Asia and especially India (the "Green Revolution"); irrigation that benefits many small farmers, especially in Asia; basic infrastructure in rural areas, especially farm-to-market roads in many low-income Sub-Saharan African countries; primary education, basic health care, and nutrition; and relief from natural and man-made disasters.

The World Bank's experience with rural development and urban poverty projects is discussed in Boxes 8.5 and 8.6. Such projects have registered many successes, as have many efforts of other donors. A review of experience reveals, however, that some aid projects intended to reduce poverty have gone wrong, although it is impossible to give a precise number. Among the reasons why some aid projects have been ineffective are the following.

**LACK OF COMMITMENT.** Some poverty-oriented projects are undertaken mainly to satisfy donors and, often, because the government wants funds for something else. Without a commitment to help the poor, agricultural credit projects intended to benefit small farmers end up making cheap loans available to large farmers, public works projects benefit contracting firms rather than the poor, and the provision of water supply and other basic urban services is diverted to wealthier neighborhoods. Enormous sums have been spent for purposes that have nothing whatever to do with reducing poverty—military expenditures, for example, and lavish "cathedrals in the desert." In 1986 the developing countries spent \$159 billion on their armed forces—about five times what they re-

### Box 8.5 The World Bank's experience with rural development projects

The World Bank's approach to poverty has varied over the years. During the presidency of Robert S. McNamara (1968–81), the Bank emphasized targeted interventions explicitly designed to benefit the poor in both rural and urban areas. In recent years these projects—mainly begun during the mid- and late 1970s—have been subjected to a number of assessments by the Bank itself. Although it is exceedingly difficult to generalize from a vast body of diverse project experience, several conclusions have emerged.

The basic goal of the Bank's rural development projects was to shift the focus of agricultural development toward smallholder farmers and to increase these farmers' productivity, output, and incomes. Rural development projects usually included agricultural credit to poor farmers, research on crops grown mainly by such farmers, extension services, the construction of infrastructure (primarily rural access roads), and some "directly productive" investments. Many projects had an "area development" focus and were undertaken in areas that suffered extreme poverty even by the rural standards of developing countries. For example, in Funtua State—the site of the Bank's first rural development project in Nigeria—the rural population had the lowest per capita income of any state in the country.

Many projects were "integrated": they involved a specified sequence of actions by a variety of agencies within the recipient countries and by the Bank itself. In fact, the phrase "integrated rural development project" became synonymous in many people's minds with the Bank's whole rural development effort in the 1970s. There were other kinds of rural development projects, too—some nationwide projects, for example, included a substantial component for small farmers or low-income producers but were not targeted on the rural poor in a specific geographic area. Several nationwide agricultural credit projects in Mexico and a nationwide agricultural research and extension project in Brazil are examples.

In 1987 the Bank's Operations Evaluation Department conducted a thorough review of 112 completed rural development projects undertaken during the McNamara years. Total Bank lending for these projects was about \$2.7 billion. The review used the simplest and most commonly accepted Bank measure of a project's "success" or "failure"—the economic rate of return. A return of 10 percent normally qualifies as successful. The evaluation found that 63 percent of the projects were successful and that the projects overall had an average rate of return of 17 percent. About 85 percent of the projects appear to have increased food

production directly in project areas. Eighty-three projects undertaken between fiscal years 1974 and 1979 are estimated to have benefited about 4.7 million farm families directly. For these projects the cost per beneficiary family at project completion was about \$1,100 (as against an estimate of \$960 when the projects were first appraised).

By now a number of lessons from these rural development projects have been documented. A few are given here.

- Many integrated projects were too ambitious and complex, and they often placed impossible demands on local leadership and institutions. As a result, they performed worse than projects with simpler designs.

- In many cases the benefits flowing from projects were not sustained beyond project completion. One reason was the Bank's tendency to create independent project management units. Although this may have facilitated implementation over the short term, it was difficult to deal with national bureaucracies once disbursements on projects were completed. Another reason was that project beneficiaries were often not involved in decisions, and they felt that they had little stake in sustaining the projects. Projects that encouraged participation worked better.

- Although there was awareness of the importance of an appropriate policy framework, finance was often granted in unpromising circumstances in the hope that governments would be encouraged to change their policies. As it turned out, the larger policy environment was perhaps the single most important factor in the success or failure of the projects. Government policies on prices, interest rates, and input supplies were frequently at variance with project objectives. Moreover, the projects themselves often proved ineffective levers for influencing overall national policies for agricultural development. Many tended to be successful "enclaves" within national agricultural systems that were still largely inefficient and inattentive to the needs of poor farmers.

The balance sheet of successes and failures for rural development projects during the McNamara years has influenced the Bank's subsequent approaches to rural poverty. Today's projects pay more attention to overall sectoral policies, place greater stress on institutional development, put less emphasis on complex multisectoral approaches, and are increasingly realistic about the feasibility of focusing project benefits precisely on narrow target groups.

### Box 8.6 The World Bank's experience with urban poverty projects

In response to the diverse problems of cities in developing countries, the World Bank in the 1970s began to expand its lending for urban development. Lending increased from a modest \$10 million in 1972 to more than \$2 billion in 1988. Much of this lending has sought to address poverty. In a sample of projects for which poverty data are available, nearly three-quarters had at least 40 percent of their funds allocated to the poor. Almost 60 percent of the Bank's total urban lending since 1972 has gone to shelter operations, although lending for the direct provision of shelter has declined substantially in recent years. Lending for transport and for water supply and sanitation are the other main components of the Bank's urban operations, and there has also been considerable lending for citywide financial and institutional reforms.

As with the rural development programs described in Box 8.5, the Bank's poverty emphasis in urban areas is prominently identified with the McNamara years. The Bank's shelter strategy of the time attracted international attention. It relied primarily on sites and services housing projects and slum-upgrading projects.

In sites and services projects, land parcels equipped with rudimentary urban services were provided to people who then either constructed their own dwellings or contributed to the construction. The projects were designed to reorient typical public sector housing policies in developing countries, which had benefited mainly middle-income households and not the poor. The projects provided beneficiaries with core houses, some infrastructure, social facilities, and employment sites. They also made available financing for plots, houses, and building materials. Typical "upgrading" projects also relied greatly on self-help schemes. They sought to improve infrastructure through a comprehensive package that included water, sanitation, drainage, solid waste removal, roads, and footpaths.

How many of these urban shelter projects were successful? As with rural development projects, it is hard to be precise. About thirteen million households are estimated to have benefited from shelter projects between 1972 and 1989. The Bank's shelter strategy showed that "housing the poor" is possible. The changes in design standards introduced by some of the projects did in fact lower shelter costs—in some cases dramatically. In Zambia, for example, houses in sites and services projects cost less than one-fifth the price

of the least expensive government-subsidized housing. In El Salvador houses in the sites and services project cost less than half as much as the cheapest conventional houses in the public sector.

The shelter projects were, however, not without problems. Assessments of completed projects have provided a number of important lessons.

- The larger policy and institutional environment can hamper urban poverty projects, just as it has rural development projects. The concentration of land in the hands of large property owners often made it difficult to acquire land for housing projects. Zoning regulations also generally discriminated against the poor. The inefficiencies of service-delivery organizations often thwarted efforts to provide municipal services to poor areas.

- It is difficult for urban poverty projects to reach the poorest people. The most comprehensive study conducted by the Bank found that people in the middle rather than the lower part of the urban income distribution tended to gain most.

- Project-level interventions, such as shelter projects, often do not have much influence on the overall urban policies of recipient countries. Some old planning and design criteria gave way to lower-cost solutions, but the laws, codes, and regulations that provide the framework for private housing development were generally left unchanged. The most recent assessment of the Bank's urban projects concluded that in most countries sites and services projects—again like many rural development projects—became "enclaves." Rarely did governments establish programs independent of external donor support. As a result, the direct provision of shelter did not have the broad, long-term impact on the sector that had been expected.

The Bank's new approach to the urban sector stresses broad policy and institutional issues and strives for a sectorwide impact. New priorities include better urban administration, improved mobilization of municipal resources (which may involve the recovery of costs for the supply of services), more efficient urban land markets, and a cleaner urban environment. Project-level interventions, such as the provision of basic urban infrastructure, will continue to be important. But projects will need to pay much greater attention than in the past to these wider issues.

ceived in aid. In 1984 they spent almost as much on arms imports as on all their health programs. The continued provision of aid needs to be carefully reexamined if it seems that developing country governments are not serious about reducing poverty.

THE SECTORAL AND MACROECONOMIC CONTEXT. In the 1970s the presumed shortcomings of "trickle-down" approaches to poverty reduction led many donors to emphasize direct, project-specific interventions. Many of these projects were successful. But projects explicitly intended to reduce poverty

were often undermined by sectoral and macroeconomic policies such as pricing policies in the agricultural sector and land use policies in urban areas. Moreover, even when projects to reduce poverty were successful on their own terms, many of them were essentially "enclaves" with little influence on national efforts to reduce poverty.

**FADDISM.** Frequent shifts in donor concerns and policies have often overshadowed the need for stable long-term strategies. A study of six Sub-Saharan African countries concluded that changes of direction were one of the main reasons that aid had not accomplished more. The study found that aid in the 1970s was characterized by "a single-minded emphasis on food security and poverty alleviation that undermined export-crop production and neglected the technological factors affecting improvement in food-crop productivity," whereas in the 1980s there was "a sharp and simplistic swing of donor attention toward efficiency and away from equity concerns." These aid-induced "zigzags" were apparent not only in agriculture but also in education and other sectors. They made projects more complicated, when success in attacking poverty called for sustained attention to a few simpler matters. For instance, the contributions that basic infrastructure can make to reducing poverty in rural areas have often been neglected in the pursuit of a grander vision of "rural development." Faddism also leads to competition among donors for "good" projects. The result has often been that too many donors are doing the same thing in the same country or—even worse—are doing the same thing differently. This wastes effort and means that the total impact of development aid is less than the sum of its parts.

**NEGLECT OF INSTITUTIONAL DEVELOPMENT.** Reducing poverty through aid calls for more than money; building capacity is crucial. Donors have unduly neglected the institutional and managerial aspects of poverty-oriented projects and programs. The reason is not want of funds; technical assistance accounts for more than a quarter of total aid. Rather, much of this assistance fails to reflect borrowers' priorities. The main form of technical assistance has been the supply of expatriate talent. The United Nations Development Programme (UNDP) estimates that donors support between 75,000 and 100,000 foreign experts a year in developing countries. Donors often prefer to gather these experts in project units outside the normal bureaucratic structure. The result is that aid con-

tributes less than it should to institution building in the recipient countries. In recent years attempts have been made to improve this aspect of aid, but much remains to be done.

**INADEQUATE PARTICIPATION.** Donors and recipients have given too little attention to sociocultural and political factors and have not been sufficiently aware of the important role that the poor themselves can play in initiatives designed to assist them. Evidence supports the view that involving the poor in the design, implementation, and evaluation of projects in a range of sectors would make aid more effective. Involvement of women has contributed to the attainment of objectives in many agricultural development projects in Sub-Saharan Africa; participation of local community organizations has improved performance in many urban poverty projects; organizations of beneficiaries in aid-supported irrigation schemes have made important contributions to the maintenance and operation of project works; and involvement of organized groups of low-income borrowers has facilitated repayment of loans in small-scale credit programs.

#### *Toward a greater role for aid in poverty reduction*

This review of successes and failures provides important lessons for future assistance. Although aid will continue to serve many diverse development objectives, an assessment of countries' policies and their likely effects on poverty should play a more important role in allocating aid resources. An aid strategy revised to make external assistance a more effective weapon against poverty should have as its centerpiece appropriately designed support for countries that are pursuing policies intended to reduce poverty. This means looking at the effects on the poor of the whole range of government policies—policies designed to expand the income-earning opportunities of the poor (Chapter 4), extend social services (Chapter 5), effect income transfers and provide safety nets (Chapter 6), and implement structural reforms while incorporating a concern for the effects of these measures on the poor (Chapter 7).

#### *Aid allocation*

Such a revised aid strategy has implications for the allocation of aid from both bilateral and multilateral sources. IDA, the World Bank's concessional lending affiliate, already extends about 95 percent

of its credits to low-income countries. Poverty—its extent and the efforts that individual countries are making to reduce it—is one of the principal criteria in allocating these resources. In recent years countries that are judged to be doing too little to reduce poverty have received a smaller proportion of resources from IDA. The approach recommended here would reinforce this trend.

Past practice in the World Bank has tended to focus on measuring the effect on poverty of particular projects (by attempting to assess, for example, what proportion of project benefits accrues to the poor). The approach recommended here is economywide. The central question is the impact on the poor of government policies as a whole. The most recent negotiations for the ninth replenishment of IDA stressed the importance of poverty criteria in allocating the organization's resources, and broad assessments of the effects on poverty of general country policies increasingly receive special attention in the economic and sector work undertaken by Bank economists. These efforts should be broadened and intensified so that external assistance from the Bank and other donors can more effectively support the kinds of policies advocated in this Report.

In assessing the overall impact on poverty of country policies and in monitoring their implementation, it is necessary to avoid an excessively mechanistic approach. Decisions will have to be made on the basis of informed judgments concerning the extent to which governments' policies are appropriate for reducing poverty. Other government and donor objectives must also be taken into account. Both the assessment and the monitoring of the influence of government policies on the poor would be greatly facilitated, however, by more systematic compilation of social and income indicators that could measure progress in implementing the two-part approach outlined in this Report. For example, data on per capita expenditures on primary education and nutrition programs could help to measure progress in providing social services to the poor. On the income side, it should be feasible to collect on a systematic and regular basis data on producer prices for small farmers, wages of daily agricultural laborers, urban unskilled wages, and relevant cost of living indices. These would complement direct assessments of the status of the poor, such as those obtained from household expenditure surveys. The World Bank has collected survey data in many countries through its Living Standards Measurement Studies, and additional surveys are in preparation.

### *Country assistance strategies*

A revised aid strategy also has implications for the design of country assistance strategies and the use of a variety of aid instruments. These would vary according to country circumstances; to a large extent they would depend on the domestic policies being pursued by recipient countries.

In countries in which policies are already consistent with the reduction of poverty, assistance to the public sector can be delivered in three ways: balance of payments support linked to the restructuring of public expenditure, "time-slices" of public expenditure programs, and investment projects. The appropriate mix would depend on the most pressing needs of individual countries. Aid for balance of payments support is especially important in debt-distressed low-income countries. It is already a key feature of the Special Program of Assistance for debt-distressed countries in Sub-Saharan Africa that are undertaking adjustment programs. Support for time-slices of public expenditure programs is also under way in a number of cases—for example, in the Bank's support for the education sector in Morocco. If the proposed aid strategy is to be effective, disbursements for both kinds of support would have to be based on agreed changes in the structure of public spending.

A particular use of general budgetary assistance is contingency funding to support safety nets. External shocks and natural disasters often coincide with (or cause) fiscal difficulties. At precisely the time that the need for transfers to the poor is greatest, governments may be least well positioned to supplement or even maintain existing programs. There is a good case for increased external assistance at such times. Emergency food aid already serves this purpose during droughts and famines (Box 8.7). When governments have in place effective safety nets, such as public works schemes, this basic idea could be extended to cover other shocks. Thus, aid programs could include agreements to the effect that external assistance would be increased in the event of adverse macroeconomic shocks to provide temporary relief while efforts to restructure the economy are put in place.

Free-standing investments should also continue to play a central role. Such investments will be vital for building and maintaining basic infrastructure and for undertaking projects in the social sectors. As discussed in Chapter 4, however, the scope for specific investments will vary between, at one end of the range, areas with high productive

### Box 8.7 Food aid and poverty

In 1989 food aid to developing countries amounted to approximately \$2.5 billion. Food aid constituted 5 to 6 percent of bilateral aid from all DAC members; it represented 12 percent of Canada's aid program and 18 percent of total U.S. assistance. The main multilateral provider is the World Food Programme, which accounts for about 21 percent of all food aid from United Nations sources. Another significant donor is the European Community; in 1989 it contributed 10 percent of all food aid.

A strong argument on behalf of food aid is that much of it represents U.S. and EC production surpluses that would not otherwise benefit developing countries. Since food aid is likely to continue to be a significant component of foreign assistance, it is important that it be an effective instrument for reducing poverty. At the global level allocation of food aid (as of aid in general) could be based more strongly on poverty criteria, as opposed to political considerations. Reform of domestic policies can also greatly improve the effectiveness of this resource in reaching and assisting the poorest within a given country.

Most food aid is provided for general balance of payments support ("program" food aid). Questions about the effectiveness of program food aid mainly concern the appropriateness and efficiency of public sector expenditures. Given good administration and appropriate policies, program food aid can free resources for poverty reduction and other development efforts without interfering with the functioning of local food markets. In India, for example, funds generated by the sale of food aid, together with the associated foreign exchange savings, accounted for 30 to 40 percent of government revenue in the mid-1960s. Some of these resources were used to create the infrastructure for the Green Revolution, which in turn led to considerable increases in food production. Program food aid can

also help to finance measures to protect the standard of living of the poor during adjustment.

Food aid is also provided for emergencies and such specific purposes as food-for-work or supplementary child feeding projects ("project" food aid). An issue with these forms of food aid is whether they are effective in providing transfers and safety nets to the poorest groups. Ensuring food security for the poor is the central objective of such assistance, but this does not necessarily entail physically supplying poor people with food. Simply making more food available in a country can help protect the poor by stabilizing prices, and food aid can be used to finance effective poverty-reducing programs that do not involve food transfers. Direct distribution can, of course, be important in emergency situations where there is a large food deficit and markets are not functioning well. Examples include the famines in Ethiopia, Somalia, and Sudan as well as the severe floods in Bangladesh in 1988, when the World Food Programme coordinated 400,000 tons of food aid through a quick-response capacity developed in dealing with previous floods.

Monetization of food aid through sale in the recipient country is often appropriate and can greatly improve the poverty-reducing potential of this form of assistance. The cash generated can be used to finance such domestic programs as rural employment schemes. Programs of this kind are able to reach the poorest rapidly and effectively. By relying on regular market channels to bring food into deficit areas, they avoid production disincentives and high internal distribution costs. In addition to providing direct assistance, monetized food aid can serve as a resource for investments in human and physical capital and so help to bring about sustained improvements in food security and in the well-being of poor people.

potential and, at the other, resource-poor regions that have little productive potential but many poor people.

Since the private sector is central to growth in labor demand, an aid strategy should support this sector. But aid will be effective only if incentives are appropriate. An evaluation of the broad framework of incentives must form an integral part of the overall assessment of country strategies. Balance of payments support can also be important here—provided that it is linked to macroeconomic management that facilitates adequate private investment. Aid can be used to reduce the demand placed on the banking system by the public sector, and this in turn will ease financial pressures on

private investment. It will also continue to have a role in more directly promoting labor-intensive activities in the private sector.

The provision of aid through these instruments cannot, however, be recommended for those countries whose policies are not conducive to meaningful poverty reduction. Yet there are large numbers of poor people in such countries. In these cases difficult decisions will have to be confronted. Directing limited quantities of aid in a highly targeted fashion toward the poorest groups would seem to be the appropriate response. For example, aid could support health clinics that serve poor women and children, immunization programs for children, and well-targeted feeding programs.

Much of the work of agencies such as UNICEF and OXFAM—in Ethiopia, Kampuchea, Sudan, and elsewhere—is precisely of this kind. The World Bank is also undertaking such work, in Zaire, for example. The goal must be to protect the welfare of the poor as far as possible while efforts to reform country policies continue. But large volumes of aid should not go to such countries until policies more consistent with the reduction of poverty are put in place.

Many countries present intermediate cases, and the choices for deploying aid are not so well defined. Again, informed judgments will have to be made on what sorts of initiatives can be effectively supported by development assistance in such countries. If, for example, a country is not providing adequate social services but is doing reasonably well at increasing the incomes of the poor, aid should be directed at improving social services. If policies are not conducive to the productive use of poor people's labor but the provision of social services to the poor is satisfactory, aid can help to maintain the stock of physical capital while efforts to encourage growth-promoting policies continue. So, some assistance to intermediate cases would be justified. But the disbursement of substantial volumes of aid should generally be confined to countries that are pursuing appropriate policies designed to generate income-earning opportunities and are providing social services efficiently to the poor.

#### *Implications for the volume of aid*

This strategy implies that an undifferentiated case for more aid cannot be made—whether aid should be increased depends on how many countries are seriously pursuing the reduction of poverty. Nor can it be argued unequivocally that aid should be reallocated from less poor to poorer countries, although the case for disbursing large volumes of aid to middle-income countries is weak. Such a reallocation would again depend on country policies.

There are two important reasons, however, for believing that a more substantial volume of aid will be required in the short- to medium-term. First, the outlook for exports and debt relief is not good for many low-income countries. Second, and more encouragingly, more countries are adopting policies consistent with the priorities urged in this Report. These include the countries eligible for the Special Program of Assistance to Sub-Saharan Africa, and there is guarded optimism that other countries may join their ranks.

At \$51 billion, the total volume of aid in 1988 might seem large in absolute terms. But it is small when viewed in a wider perspective—especially when it is recalled that a substantial part of this amount, mainly that from bilateral sources, is not oriented toward development. Total aid from DAC members amounts to only 0.36 percent of their combined GNP. Moreover, the development assistance provided by industrial country donors in recent years has been only about 5 percent of their military expenditures. These donors spent \$31.6 billion for aid and \$666 billion for military purposes in 1986. In recent years aid has represented only about 1.4 percent of central government expenditures for DAC members (and only about 0.8 percent for the United States). A substantial increase in the resources for fighting poverty in the poorest countries appears entirely affordable. It is a matter of political commitment and the reassessment of donors' priorities.

DAC projects an increase of only 2 percent a year in real terms in its members' aid over the medium term. This would yield aid of \$64 billion in 2000, but it means that the growth of official development assistance would be slower than the growth of members' GNP, which is estimated at about 3 percent in this Report. The ratio of aid to GNP would decline even further.

This chapter has stressed that in the longer term the progress of developing countries—including their progress in reducing poverty—will demand substantially more reliance on the countries' own domestic resources and on their income from foreign trade and considerably less dependence on external official support through aid. But economic self-reliance is still far off for many poor countries. Real growth in aid of only 2 percent a year is an unacceptably weak response to the challenge of global poverty. The international community needs to do better—much better. At a minimum, it should ensure that aid does not fall as a proportion of donors' GNP. A 3 percent annual increase in aid between now and 2000 would produce a total amount of \$73 billion in 2000. Preferably, donors should aim much higher. Aid could reach \$108 billion in 2000 if donors with aid-to-GNP ratios of less than 0.5 increased their aid to that proportion and those with ratios of more than 0.5 maintained their current performance. Attainment by all donors of the widely accepted international target of ODA as 0.7 percent of GNP (with those donors having already attained the target remaining at their current aid ratios) would increase aid to \$144 billion. Moreover, if increases in aid volume were accompanied



by significant reallocations toward countries that have policies geared toward the reduction of poverty, the effects on the external resources available to those countries could be even more dramatic.

The goal must be to make aid a more effective weapon in the war against global poverty. This entails challenges for donors and recipients alike.

Donors must be prepared to supply substantial volumes of aid to countries that are serious about reducing poverty. Recipients must increasingly demonstrate that seriousness. Together they can learn from past successes and failures and make aid a more effective instrument for reducing poverty in the future.