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ECONOMIC DEVELOPMENT AND THE EFFECTIVENESS OF FOREIGN AID:
A HISTORICAL PERSPECTIVE

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ABSTRACT

In this paper I discuss the effectiveness of foreign aid from a historical perspective. I show that foreign aid is a relatively new concept in economics, and I emphasize the role of exchange rate policies in the foreign aid controversies of the 1970s through 1990s. I show that in the early 1980s there were major changes in views regarding aid and agriculture. I emphasize the role of "ownership" of aid programs by the recipient countries as a way of increasing effectiveness. I argue that there is little hope of making progress in these debates if the economics profession continues to rely, almost exclusively, on cross section regressions. In order to move forward, these analyses need to be supplemented by in depth case studies that follow a country's history for many decades.

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I. Introduction

One of the most controversial issues in development economics refers to the effectiveness of foreign aid. Three distinct camps may be distinguished in this debate: First, there are those that believe that official assistance is ineffective, and has harmed poor countries throughout the years. According to this view, advocated by authors such as Easterly (2014) and Moyo (2010), official aid creates dependency, fosters corruption, encourages currency overvaluation, and doesn't allow countries to take advantage of the opportunities provided by the global economy. At the other end of the spectrum are scholars like Sachs (2009) and Stiglitz (2002), who believe that levels of aid have historically been too low, and that (large) increases in foreign assistance could be greatly effective in helping reduce poverty. According to these scholars this would require rethinking the way in which aid is provided. In particular, specific interventions, such as anti-malaria programs, should be emphasized. The third group is less vocal, and includes authors such as Collier (2007), who has emphasized the role of a number of "traps" in perpetuating destitution, and Banerjee and Duflo (2011) who argue that the use of "randomized control trials" may help devise effective and specific aid programs in the war against poverty and underdevelopment.

In this paper I discuss the effectiveness of foreign aid from a historical perspective. The paper differs from previous efforts on the subject in a number of respects:

- First, I place the effectiveness debate within the general evolution of ideas on development economics during the last sixty years. I cover five key phases of development thinking: (a) I begin with the "planning approach" that was dominant in the 1950s. During this period economists that studied growth relied mostly on models that emphasized the role of capital accumulation (i.e. the Harrod-Domar model). (b) I then move to the acceptance of the neoclassical model developed by Solow in the 1960s, a model that stressed the role of productivity growth and factor substitutability. (c) Next, I deal with the disillusionment with aid and planning that sprung from successive crises in Africa and Latin America during the 1970s and 1980s. (d) Next, I discuss ascendance of a view that encouraged openness and market-orientation during the years of the "Washington Consensus" in the 1990s. And (e) I end with some reflections on the more pragmatic current times that emphasize the need to evaluate programs and develop small scale projects.

- Second, I show that the idea that advanced countries ought to provide assistance to poor nations is a relatively new concept in economics. Moreover, in many rich countries – including in the United States – there was a great deal of reluctance to embrace it. It was not until the 1950s, and mostly as a result of the Cold War, that foreign aid became a regular component of Western countries' foreign policies.
- Third, I emphasize the role of exchange rate policies in the foreign aid and development controversies of the 1970s, 1980s and 1990s. I show that the unwillingness to adjust currency values in poor countries was at the center of most disputes between those nations' authorities and the donor community. In dealing with these issues I focus on the role of incentives and on the poor performance of the agricultural sector in many developing countries, especially in Africa. I show that in the early 1980s, and after most of that continent had been in crisis mode for almost two decades, there were major changes in views regarding exchange rates, agricultural performance and aid. This new approach was strongly influenced by a major World Bank Report (the Berg Report).
- Fourth, I emphasize the role of the "ownership" of aid programs by the recipient countries as a way of increasing effectiveness. I argue that "aid ownership" is made up of many elements, including the coordination of programs across aid agencies, multiyear plans and financial commitments, a higher percentage of funds for budget support (as opposed to program funding), and consultation with the civil society. I show that the emphasis on "ownership" drastically changed for the better the relationship between aid agencies and African governments in the mid 1990s. The improvement in aid effectiveness helped a number of countries to become "success stories."
- And fifth, in dealing with recent controversies on aid effectiveness, I discuss the methodological approaches followed by different authors, and I argue that there is little hope of making significant progress in these debates if the economics profession continues to rely heavily on cross section and panel regressions. In order to move forward and find out under what conditions aid is helpful and when it fails, these works need to be supplemented by in depth case studies that follow a country's history for many decades, focus on specific details of policy, understand

> the way in which the authorities relate to aid officials, concentrate on the political economy of reforms, and scrutinize the beliefs of politicians, policy makers and other key players. Only then will the profession be able to understand the intricacies of foreign assistance and its level of effectiveness.

The rest of the paper is organized as follows; In Section II I deal with the early views on development polices and foreign aid that sprung from the Harrod-Domar model of growth and the theories of "unlimited supplies of labor" of W. Arthur Lewis; I call this approach the "planning" perspective to development policies. In Section III I discuss the new views on development and aid that emerged in the late 1970s and 1980s. I focus on the cases of Latin America and Africa, I review the criticisms in the influential Berg Report of 1981, and I deal with the policy prescriptions of the Washington Consensus. In Section IV I focus on the evolution of policy views (and actions) on official foreign assistance, and I review and evaluate the technical literature on aid effectiveness. I deal with some of the most salient political economy aspects of foreign aid, and I show that this is a relatively new concept in economics. I point out that, in spite of increasing sophistication in the use of statistical techniques, the results of econometric studies based on cross sections (or panels) of countries are largely inconclusive. In Section V I offer some final reflections On the interplay between aid policies and development thinking and models.

II. Foreign aid and the planning approach to economic development: 1950-1982

During 1960s and 1970s most development economists were skeptical about markets, and believed that in poor countries some form of planning had to guide resource allocation. According to this view, protectionist policies provided the most effective way of fostering industrialization and encouraging growth. Most economists that supported the planning perspective believed that the state should own large firms, banks, and trading companies. Some eminent representatives of this approach included Ragnar Nurkse, Paul Rosenstein-Rodan, and Albert Hirschman.[1]

The "planning approach" became particularly influential in Africa, a continent that during the 1960s was beginning to emerge from a long colonial period. Many African independence leaders were educated in the United Kingdom and were highly influenced by Fabian Socialist ideas. For example, Julius Nyerere, from Tanganyika, attended the University of Edinburgh; Jomo Kenyatta, from Kenya, and Seewoosagur Ramgoolam, from Mauritius, went to both University

[1] Of course, there were significant differences among the representatives of what I have called the "planning perspective." This was anything but a uniform group.

College and the London School of Economics; and Kwame Nkrumah, from Ghana, was enrolled in the London School of Economics. However, not all Fabian socialists in Africa were exactly alike; in each country different policies were implemented at different times. In Kenya and Zambia, for example, planning was light and, at least until the late 1970s, market signals were allowed to operate in most sectors. In contrast, and as Ndulu (2008) has pointed out, Tanzania, Mozambique and Ethiopia followed a more intense form of planning where markets were repressed significantly and the state played a growing role in the productive, investment, and distribution spheres. In these countries most large firms, banks and insurance companies were nationalized during the late 1960s and early 1970s.[2]

Planning was also popular in other parts of the world. In India, Nehru strongly believed that the state should control most decisions regarding production, investment, and distribution. Indian planning efforts were developed by Professor P.C. Mahalanobis, who during the late 1950s became a legend of sorts among development practitioners from around the world. In Latin America planning saw its heydays during the 1960s and 1970s. Indeed, after President John F. Kennedy announced the *Alliance for Progress* in 1961, planning became a fundamental component of policy formulation. Having a well-functioning Department of Planning was, in fact, a precondition for obtaining aid under the *Alliance* guidelines. Planning in Latin America, however, was significantly lighter and less intrusive than in Africa and India. Planning was also important in forging economic policies in Sukarno's Indonesia and in Razak's Malaysia.[3]

II.1 Capital accumulation, unlimited supplies of labor, market failures, and protectionism

At the core of the planning view of development was the notion that the accumulation of physical capital was the main source of economic growth, and that the availability of labor was not a major constraint to economic expansion; productivity improvements were not considered to be a major source of growth. These beliefs were based on two theoretical frameworks that had become popular in the 1950s: the Harrod-Domar model that emphasized the roles of the capital-output ratio and the savings rate in determining long term growth, and Arthur W. Lewis (1954) unlimited supplies of labor model that assumed that large quantities of labor were available at

[2] As Ndulu (2008) points out, Mauritius's Ramgoolam followed a pragmatic path, and never succumbed to the promises of full-fledged planning, not even of a "light" variety.

[3] For a discussion, see Edwards (2014).

very low (almost zero) wages.[4] According to these models, policies aimed at raising the aggregate savings and investment ratios were fundamental components of any successful development strategy. In countries where domestic savings were very low, these would be supplemented with foreign savings in the form of foreign aid. At the same time, the government would make efforts to generate (or "mobilize") additional resources to finance capital accumulation and industrialization. These resources, in turn, would come from "surplus" generated by the primary (agricultural, timber, and mining) sectors.

A central assumption of the "planning approach" was that markets didn't work well – or, at least, not very well --, and that if left on their own they would generate undesirable outcomes. These "market failures" were the result of a combination of factors, including the absence of competition due to the small scale of operation of most firms, consumers' lack of knowledge, incomplete information, politicians that were captured by multinational and large domestic corporations, and the exploitation of poor countries by rich ones.

Another key belief of the planning perspective was that poor countries' terms of trade would experience a secular deterioration. According to this view, promoted by Hans Singer (1950) and Raul Prebisch (1950), among others, the global demand for developing countries' exports (commodities) had a low income elasticity, while advanced countries exports (manufactured goods) had a high elasticity. As a consequence, the relative prices of poor nations' exports were destined to decline through time. This called for a rapid industrialization process, which had to be encouraged through an array of subsidies, preferential treatments, protective import tariffs, licenses and quotas, outright prohibitions, and mandated allocation of credit.

Marxist and neo-Marxist thinkers provided a more extreme version of this view, and argued that poor countries "depended" on rich nations for markets, capital equipment, consumption goods, and financing. According to "dependency theorists," such as Samir Amin and André Gunder Frank, poor countries had to severe economic and commercial ties with rich nations, including, in particular, former colonial powers. This required political will, as well as the implementation of "South-South" trading arrangements. Other dependency theorists, including Fernando Henrique Cardoso and Enzo Faletto in Latin America, stayed away from

[4] Harrod (1939), Domar (1946).

doctrinal Marxism, but still emphasized the relations of dependency between the center and the periphery, and called for rapid industrialization.[5]

Some supporters of the import-substitution strategy—and most notably Albert O. Hirschman—argued that in order for this policy to succeed, two conditions were required. First, protectionist measures had to be temporary, and import tariffs had to be lowered through time. More generally, import tariffs and other restrictions on international trade had to be sufficiently high as to protect the targeted industry, and low enough as to act as a "pressure mechanism" that forced producers to improve productivity. And second, only selected industries should be protected. This recommendation was part of Hirschman's conviction that a healthy and successful growth process was always "unbalanced," and that some industries and sectors were to grow faster than others for prolonged periods of time. Hirschman contrasted his "unbalanced growth" view with the indiscriminate creation of large state-owned manufacturing firms, and massive and blanket protection. This latter perspective, was associated with the "big push" approach to industrialization, and was supported by Paul Rosenstein-Rodan, an early advocate of large, ambitious and detailed plans to forge comprehensive development strategies.[6]

According to Hirschman's theory—which became very popular in academic and policy circles—trade restrictions should be used to protect and encourage those sectors with strong "forward and backward linkages." That is, protection should be provided to those industries whose expansion would, at the same time, feed into other promising industries, and demand inputs and materials from deserving sectors. During the 1960s and 1970s steel was usually mentioned as an example of an industry with significant forward and backward linkages. On the one hand, steel mills required iron ore and coke coal, and on the other, the finished product could be used in the manufacturing of white goods, automobiles, trucks and tractors, and in construction. The proper implementation of the "linkages" model required a remarkable amount of fine tuning and very precise and detailed knowledge of the economy; indeed, it required the type of knowledge that no government official—not even the best trained, most cable and well informed ones—was likely to have, or ever acquire. Which industries had the greatest linkages? By how much should they be protected? And, for how long? What was the combination of import tariffs, quotas and licenses that would provide the adequate "pressure mechanism" to

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[5] See Amin (1977), Frank (1969), Cardoso and Faletto (1969),

[6] See Hirschman (1958), Rosenstein-Rodan (1958).

force firms to become efficient? And, more important, how to make sure that policy makers were not captured by lobbyists (either from the private or parastatal sectors) that claimed that their specific sector had extremely high linkages and was utterly deserving of protection? As Carlos F. Diaz Alejandro put it, the problem with Hirschman's linkages approach was that its policy implications were extremely complex and were likely to become "dangerous in the sloppy hands of mediocre followers."[7]

As in turns out, in most poor countries—including in the Latin American and African nations—protection became general and massive, and subsidized industries with a high degree of linkages, low linkages, and no linkages at all. In many countries it took the private manufacturing sector no time to capture policy makers and to convince them that their particular industry was exceptional, had great promise, contributed to the process of technological transfers from the advanced world, was essential for bettering social conditions, and deserved to be protected by tariffs, quotas and even straight prohibitions. In other countries managers of state-owned enterprises played a similar game, and were able to convince policy makers to erect high protective walls around their specific industries. In many countries the maze of regulations became so intricate that it paid to obtain exemptions. Of course, those that managed to become sole importers at low (or zero) import duties made fortunes in very short periods of time. Tariff books throughout the Third World became huge catalogs of import duties for tens of thousands of goods; these fat volumes described the extent of restrictions and regulations, presented sliding tariffs' schedules, detailed the coverage of prior licenses and the levels of surcharges, and specified a number of exemptions.

II.2 *Elasticity pessimism and the dread of devaluation*

Supporters of the planning perspective believed that in poor countries producers and consumers' responses to price incentives were limited, and that peasants' efforts were not significantly affected by changes in crop prices. Planners were especially skeptical and pessimistic regarding the role of exchange rate changes in the adjustments process. They believed that trade elasticities were low and that the "structure" of the economy was more important than prices in foreign trade – this view came to be known as "elasticity pessimism." According to the Marshall-Lerner condition, if the sum of the price elasticities of demand for imports and of the supply for exports is lower than one (in absolute terms), currency devaluation

[7] Diaz Alejandro, (1984), p. 113.

would fail to improve the balance of trade. [8] This view was particularly prevalent among many development economists that worked in Africa; many of them argued that instead of relying on price signals through exchange rate changes, exports could be encouraged through large marketing boards that would buy crops from peasants and market them globally.[9]

Planners' resistance to devaluation was also based on the idea that under certain conditions devaluations could be contractionary, reducing the level of aggregate demand, a point made by Hirschman in 1949, and emphasized with great force by Diaz Alejandro in 1963. Most supporters of the planning perspective also believed that currency devaluations were passed onto domestic prices rapidly and fully, thus fueling inflation and reducing real wages in the urban sector. These "structuralist" views on exchange rates were in contradiction with those developed at the IMF, where it was thought that a properly implemented devaluation—that is, one accompanied by a reduction in aggregate expenditure or absorption—would succeed in improving the balance of trade. According to the Mundell-Fleming model developed at the IMF, devaluations are expansionary, resulting, under most circumstances, in an increase in aggregate demand – see Fleming (1962), Mundell (1962).

During the 1970s and 1980s, policy makers in Africa were particularly skeptical about the benefits of exchange rate adjustments and nominal devaluations. Ghana and Tanzania provide good examples of political resistance to stabilization-cum-devaluation policies. On January 13 1972, the Ghanaian army staged a coup d'état; it was the third change of government in less than six years.[10] The plotters – led by Colonel Ignatius K. Achempong – argued that the devaluation of the cedi, undertaken seventeen days earlier (on December 27 1971) was one of the main reasons for overthrowing the government of reform-minded Prime Minister Kofi Busia. According to the new rulers, exchange rate adjustment had no beneficial effects, and would not cure the massive balance of payments crisis that had erupted in 1971. Devaluation would only result in higher prices, lower real incomes and higher wealth for those that had stashed foreign currency. According to Achempong and his advisers the crisis was due to the trade liberalization polices pushed by the Busia administration, the decline in the price of cocoa, and to the decision by Western donors to severely cut aid to Ghana; in their view, the massive overvaluation of the

[8] See Machlup (1950) for an early discussion on elasticities pessimism. See, Hirschman (1949) and Diaz Alejandro (1963) on contractionary devaluation; see Edwards (1989) for an empirical analysis.

[9] In Africa, marketing boards were a legacy of colonial times.

[10] For a fascinating analysis of this episode see Denoon (1986).

currency had played no role in generating the large external imbalances faced by Ghana. Twenty three days after the coup the devaluation was reversed, and the cedi-dollar rate was moved back to its old value. The years that followed were years of mounting overvaluation, growing imbalances, rapid inflation, suffering, devastation, and failed stabilization programs.[11]

Tanzania provides a second illustration of the resistance to devaluation in Africa. In November 1979 the IMF informed President Julius Nyerere that it would provide a large loan to Tanzania, conditional on the government implementing a macroeconomic adjustment program. The main components of this program were a large devaluation of the shilling, fiscal restraint, and parastatal reform. An agreement with the IMF was important for Tanzania, since it would unlock foreign assistance from other donors, including the World Bank. Nyerere reacted to the IMF proposal with disbelief, and announced that his government would not change the value of the currency. He then proceeded to expel the IMF mission from Dar es Salam. What followed was a seven year stalemate, where the IMF insisted on devaluation and the authorities refused to move in that direction. In the meantime economic conditions in Tanzania deteriorated rapidly.[12] This situation continued until 1986 when, after Nyerere had decided not to run for reelection, an agreement was reached between the IMF and the new government. The adjustment program called for a major devaluation, and for the adoption of a crawling peg regime that would devalue the shilling gradually every month. One of the goals of this policy was to eliminate (gradually) the black market premium, which in 1984 had reached 700%. One of the consequences of the 1986 Stand By agreement with the IMF was that it unlocked the release of aid funds from the World Bank and a number of bilateral aid agencies, including from the Nordic countries.[13]

Those that opposed devaluation in Africa justified their views through a two part argument: First, they attributed the region's crisis of the 1970s and first half of the 1980s to external factors—armed conflicts, the collapse of the East African Community, droughts, and the deterioration of the terms of trade. Second, and more importantly, they argued that devaluation would not work for a number of political and structural reasons, including the fact that in planned economies the authorities allocated foreign exchange in a direct (and often political)

[11] See Mosley, Harrigan and Toye (1991), Volume 2 Chapter 14..

[12] See Coulson (2013).

[13] See Edwards (2014).

fashion, and markets were not responsive to price incentives.[14] Another recurrent point made by the opponents of devaluation was that an exchange rate adjustment would not improve that country's international terms of trade.[15] Although this was correct, it was immaterial, as the key question was whether devaluation would improve the domestic relative price of tradable goods, and thus provide the incentives for expanding agricultural production and exports.

In the 1980s, opponents of devaluation also criticized other components of the IMF and World Bank policy recommendations, including the call for liberalizing interest rates, liberalizing imports, removing price controls, reducing government expenditures, and reforming parastatals.[16] Another contentious issue had to do with the timing and speed of the adjustment programs. Some authors asked, rhetorically, what was the appropriate dose which cures the illness without killing the patient. Around that time a number of academic researchers were addressing that question. For instance, in an article partially motivated by the economic conditions of Sub Saharan Africa in the first half of the 1980s, Edwards and Montiel (1989) analyzed the consequences of delayed exchange rate adjustment. They found that it almost never paid to wait. The actual consequences of lingering and postponing adjustment and devaluation depended on the source of the disequilibrium: if this was fiscal in nature, delaying adjustment greatly increased the costs of the crisis; if, on the other hand, the causes of the initial imbalances were related to terms of trade deterioration, postponing the adjustment magnified instability.

The idea that peasants didn't respond to price incentives was popular among a number of development economists in spite of the fact that there was a growing literature that suggested that this was not the case. In his path breaking 1953 book *Penny Capitalism*, University of Chicago anthropologist Sol Tax showed that very poor Guatemalan peasants responded to price incentives in ways similar to significantly more educated farmers in the advanced nations. Also, econometric work undertaken in the 1960s by T.W. Schultz and many of his students, showed peasants' supply response to price changes and other monetary incentives was substantial. In spite of this evidence, during the 1970s many development experts still adhered to the traditional "low elasticities" model.

By the early 1980s the dominant view on peasants' behavior began to change, as an increasingly larger number of scholars, practitioners and policy makers slowly came to the

[14] This latter point was related to the "elasticities pessimism" view, prevalent in some quarters at that time. See, for example, Malima (1986, p. 132), Singh (1986).

[15] Malima (1986, p. 132), Singh (1986).

[16] Malima (1986).

conclusion that elasticties were, in fact, quite large. The publication, in 1981, of Robert Bates' book *Markets and States in Tropical Africa* was particularly influential in this regard. In the preface to a new edition, Bates (2005, p. 10) wrote: "[I] assume[d] that farmers—even peasant farmers—respond to economic incentives. I was willing to make this assumption because, having lived in village communities, I knew it to be true." (See Section IV for further details).

Interestingly, during the 1970s there was little concern about the possible effects of foreign aid on the real exchange rate and international competitiveness. This was for two reasons: first, the concept of "Dutch Disease" had not been developed fully, and had not become central to economists' concerns about the macroeconomics of development. And second, the belief that peasants' were largely unresponsive to relative price changes meant that the issues of real exchange rate appreciation was considered, by many analysts and policymakers, to be of second order importance. However, during the 1980s there was a renewed interest in the "transfer problem" and a number of economists developed models of real exchange rate responses to capital inflows. Many of these works sprung from analyses that asked how natural resources' booms impacted on a country's relative prices, real exchange rates and competitiveness.[17] These studies showed that in order for the actual resource transfer implied by foreign aid flows to take place, the recipient country had to experience a real exchange rate appreciation or loss in competitiveness. The extent of appreciation varied from country to country, and was related to an array of elasticities. As the 1980s unfolded, many authors considered the Dutch Disease- related phenomenon s one of the (indirect) costs of foreign aid.[18]

II.3 *Planning and input-output analysis*

Economists that supported the planning view had confidence in their models' abilities to calculate accurately the "requirements"—both direct and indirect—for achieving certain development targets. These figures were obtained by manipulating, in different ways, input-output matrixes. A byproduct of these exercises was the computation—as the dual to the planners' optimizing problem—of shadow prices. These accounting prices were supposed to reflect the true value of different goods—and, thus, took into account the distortions created by "market failures"—, and were to be used in making investment and other decisions.

[17] See, for example, Neary and Van Wijnbergen (1986), and Van Wijnbergen (1986).

[18] See Van Wijnbergen (1986) and Edwards (1989).

In addition, these models would indicate which sectors were to receive larger allocations of foreign aid funds. A serious limitation, however, was that in many developing countries (and in particular in Africa), there were no data to construct detailed and accurate input-output matrixes, and in those countries were the data existed they were often outdated, and didn't incorporate the latest technological developments in the production process. As a result, calculations in most Five Year plans in Africa were made using less sophisticated techniques. This didn't imply that these plans were less ambitious or demanding than those elaborated in countries that did have detailed information, such as some Latin American nations.

Tanzania provides a good example of the use of input output matrix for planning purposes. In the early 1970s a matrix was constructed by a group of foreign advisers. This matrix was fairly detailed for a developing country; it had 45 producing sectors, 5 final use sectors, and 5 primary input sectors. The government used this tool to decide which sectors to encourage and how to allocate some of the funds provided by the aid agencies. The most important criterion for was that the favored industry would have very strong "backward and forward linkages" in at least three areas: employment, foreign currency generation, and growth. Research undertaken by Kim in the mid-1970s (and published in 1978) showed that "export crops," "mining," and "hotels" were the only three sectors in the economy that had high backward and forward linkages in the three areas mentioned above. What is ironic is that none of these sectors was favored or promoted by the government. In fact, export crops were taxed through at least two mechanisms: low prices paid by marketing boards to producers, and a highly overvalued exchange rate. Mining was not encouraged due to its very high capital requirements and the government's unwillingness to accept foreign direct investment (FDI) to develop the sector. And tourism was looked down for ideological reasons: it was though that catering to Western tourists was an undignified activity. Although other researchers also showed that industrialization policies were moving in the wrong direction, the government did not pay attention to their results[19]

Of course, not all enthusiasts of the planning approach were alike; some believed that what poor countries needed was "indicative" or "light" planning that would provide broad guidelines to the private sector. This, for example, was the view implicit in the *Alliance for Progress* in Latin America. According to this approach the economy would be organized around three productive sectors: a small sector comprised of state-owned enterprises, mostly in heavy

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[19] See Kim (1978) and the bibliography cited there. See also Coulson (2013) and Edwards (2014)

industries, and natural monopolies; a "mixed-sector" where firms would be jointly owned by the state and private investors; and a private sector made up of small and medium size firms, and retail trade. Light planning was also the dominant view in the 1960s, 1970s and 1980s in Kenya.[20]

One of the most influential supporters of the planning perspective in Africa was René Dumont, a French agriculturalist and development expert that, with time, forged very close relations with most African leaders. His book "A False Start for Africa," originally published in 1962 as "*L'Afrique Noir est mal partie*," and translated into English in 1966 with an introduction by Thomas Balogh, was highly influential. In it he argued against the excessive use of foreign experts and technical assistance financed with foreign aid, and pointed out that for a poor country to develop, political organization and political will were more important than the technical aspects of the plan. Dumont was also a great supporter of rapid industrialization behind a wall of import tariffs, licenses, quotas and prohibitions. According to him, "[i]ndustrialization is…a symbol of economic progress… Giving priority to agriculture alone is a typically reactionary position… Custom protection on a national level, and later on the creation of the African Common market, itself protected, will be virtually essential… Accelerated agriculture development will be more of a corollary… to this necessary but difficult industrialization" (Dumont 1966, p. 103-4). With time, however, Dumont became rather disillusioned with the turn of events in Africa and deplored the burocratization of economic policy in general, and planning in particular.

III. Crisis and criticisms: Openness, markets and new perspectives on development

The war of ideas on economic development intensified during the late 1970s, as more a more developing countries in Latin America, Africa and parts of Asia experienced (very) low growth and deteriorating social conditions. This "war" reached an inflection point in the early 1980s when a growing number of academics began to question the dominant planning paradigm. In Latin America the breakpoint came with the Mexican crisis of 1982, and the realization that every country in the region had become extremely vulnerable to external shocks. In Africa the early signs that views on development were changing came with the release of the "Berg Report" by the World Bank in 1981 (see the discussion below for details). Political events in the advanced nations, and in particular the elections of Ronald Reagan in the U.S. and Margaret Thatcher in the U.K. also affected policy thinking about development. As the 1980s unfolded views that

[20] On Latin America and planning see, for example, Edwards (2010), on Kenya see Ndulu et. al. (2008)

emphasized the role of openness, competition, export growth, macroeconomic stability and markets became increasingly influential among development experts. At the same time, these views made important inroads in the multilateral institutions and, in particular, at the World Bank. Naturally, changing perspectives on development strategies affected the idea on how much aid to provide, how to dispense it, and which sectors (or programs) to emphasize. These changing views on aid evolved at different speeds in different countries and institutions. Change was rapid in the United States, the United Kingdom, and the Bretton Woods institutions (IMF and World Bank); it was much slower in other advanced nations, including in the Nordic countries, the major providers of aid to Sub Saharan Africa.

Research on the effects of protectionism on efficiency and economic performance was particularly influential in helping change the views on development policy and foreign aid. Among these works, books by Little, Scitovsky and Scottt (1970) and Balassa (1971) led the way by pointing out that protective structures could range from a highly negative degree of protection (mostly in the agricultural sector) to several hundred (and even thousand) percent in some industries. These findings were confirmed and expanded by a large and ambitious National Bureau of Economic Research project on protection and economic performance led by Bhagwati (1978) and Krueger (1978). This multi country study showed that in most poor countries the tariff configuration generated a severe "anti-exports" bias. Further, Bhagwati and Krueger showed that in the presence of quantitative restrictions to trade (import quotas and licenses) a devaluation reduced the anti-exports bias significantly.

The contrast between successful East Asian "tigers," on the one hand, and the Latin American and African countries on the other, also influenced the switch in paradigm in development economics. By the late 1970s most nations in Latin America had come to a standstill, and many experts talked about the end of the "easy phase" of import substitution. In most countries productivity growth was extremely low, or even negative. Worse yet, after decades of planning, protectionist policies, and large volumes of aid provided within the framework of the *Alliance for Progress*, poverty had not declined and the region's dismal income distribution had not improved. In the early 1980s Mexico was affected by a major external crisis that rapidly spread to the rest of Latin America: the so-called "lost decade" was about to begin. The years that followed were years of sorrow, frustration, and soul searching. As time passed, and more and more countries returned to democratic rule, a broad rethinking of

economic strategy took place. By the early 1990s almost every country in Latin America—the main exceptions being Cuba and Haiti—had initiated a reform program that followed the blueprint of what has been called the "Washington Consensus."[21]

III.1 *New views on Africa*

In 1981 two major and highly influential publications presaged the change in views regarding economic development and foreign aid in Africa: The World Bank's *Accelerated Development in Sub-Saharan Africa: An Agenda for Action*, universally known as "the Berg Report" after its main author, Elliot Berg, and Robert Bates' *Markets and States in Tropical Africa: The Political Basis of Agricultural Policies*. Although very different in terms of their genesis and objectives, these two books made a simple and yet powerful point: the poor performance of the African economies was mostly (but not exclusively) the result of bad policies that put bureaucrats' interests ahead of those of the people, and that had stifled incentives for growth, innovation and productivity improvements in the agricultural sector. Also, both works pointed out that, in contrast to what planning models assumed, African governments were far from being benevolent institutions that tried to maximize society's welfare. Bates and Berg argued that government officials—including the managing echelons of parastatals, marketing boards, and state-owned banks—had captured the state apparatus and were using it for their own benefit as well as for that of their immediate supporters, families and friends.

In addition, both works questioned the effectiveness of foreign aid. In particular, both authors argued that for a long time the aid institutions – both bilateral and multilateral – had supported policies that distorted incentives in the agricultural sector, depressed commodity prices, discouraged innovation and productivity growth, and retarded growth.

Bates analysis was rooted in the "rational choice" perspective developed by political scientists—sometimes referred to as the "new political economy"—, and concentrated on which interest groups benefited and which ones lost from certain policy options. He pointed out that in Africa government policy taxed farmers through several channels: the low producer prices paid by marketing boards, the overvalued exchange rate, and the high prices of consumer goods that farmers consumed. The latter was the consequence of the protectionist policies aimed at promoting industrialization. At the same time, in many countries government policies tended to help farmers

[21] For a detailed discussion on the policies of the Washington Consensus see Williamson (1990).

through the subsidization of inputs and capital goods. Bates persuasively argued that the final net effect, however, was significant taxation, and a strong discouragement of agricultural activities.

By looking at the problem through a "rational choice" prism, Bates went beyond explaining the effects of certain policies, and discussed *why* those policies were undertaken, even if they were detrimental for society as a whole. One of the most important conclusions of the rational choice approach is that policy decisions are the result of distributional struggles, and reflect the structure of power in a particular country. Learning that certain policies are technically inferior to other policy options is not enough for changing the course of action. In his concluding chapter Bates argued that the costs of anti-agricultural policies were rapidly climbing. This meant that political support for the ruling coalition was eroding, and that political change looked possible. The nature of this change, however, was uncertain, and depended on the specific characteristics of each country. According to Bates a serious obstacle for deep and meaningful reform was that eliminating the anti-rural bias required major devaluations, which were strongly opposed by urban-based interest groups.

The Berg Report went beyond an evaluation of past performance, and made a number of recommendations for future policy changes. In many ways the reforms undertaken in a number of African nations in the mid to late 1980s were (partially) based on the suggestions made in this report. Broadly speaking, it called for drastically reducing the role of the state in economic activities, encouraging private sector participation, reducing protectionism to the industrial sector, eliminating fiscal imbalances, devaluing overvalued currencies and making sure that these stayed in line with fundamentals, encouraging agriculture, introducing new cultivation methods, and reforming (or better yet, dismantling) parastatals. The Report also called for reforming aid. In particular it recommended greater flexibility in terms of funds' use, increased coordination across donors, and a major increase—a doubling—of aid in real terms.

The publication of the "Berg Report" generated a strong response by most African governments and their supporters. There were two fundamental reactions. First, it was argued that the World Bank was disassociating itself from the policies undertaken in Africa in the past, pretending that it had played no role in their formulation. In that regard the critics were right, and the Bank's position was, to say mildly, disingenuous. For example, for years the World Bank was enthusiastic about Tanzania's development strategy, including its devastating agricultural policies, the "villagization process" that forcefully moved more than 10 million peasants from their homes,

and the reliance on protectionism to encouraged industries with forward and backward linkages. Similar stories could be told of other African nations.[22] As Loxley (1983) argued, the Bank should have recognized that two decades of "misguided" policies in Africa were, at least in part, the consequence of its own "misguided" advice.

A second reaction to the Berg Report had to do with its claim that Africa's economic failure was mostly the result of policy mismanagement, and that external factors had played a minor role in the continent's very poor performance. In particular, World Bank critics disagreed strongly with the assertion that "trends in the terms of trade cannot explain the slow economic growth in Africa in the 1970s because for most countries… the terms of trade were favorable or neutral."[23] According to the Bank critics this conclusion depended on which years were used as a base to calculate changes in terms of trade. The Berg Report insistence that external factors were unimportant was also at odds with the position espoused by the African nations in the "*Lagos Plan of Action for Economic Development of Africa,*" a document released in 1981 (but signed a year earlier). The *Plan for Action* attributed the region's penuries to external shocks and to the instability of the world economy. This long and all-encompassing document called for African countries to step up efforts for industrialization and self-reliance, and proposed the creation of a common market that would eventually lead to the formation of an African Economic Community. In addition, it stated that former colonial powers were trying to impose their own policies to the African nations: "Africa was directly exploited during the colonial period and for the past two decades; this exploitation has been carried out through neo-colonialist external forces which seek to influence the economic policies and directions of African States." The Plan foe Action also called for an increase in foreign aid to the region by both multilateral and bilateral aid agencies.

III.3 Markets, development and the "Washington Consensus"

The fall of the Berlin Wall in November of 1989 accelerated the decline in the popularity of planning, and generated increased interest among politicians in development strategies based on markets, competition, and export expansion. The experience of the East-Asian Tigers with export-led growth attracted considerable attention, and a number of works were penned on the policies followed by those nations. One of the messages that emerged from these case studies was

[22] For details see Coulson (2013). See also Lofchie (2014).

[23] World Bank (1981, p.19).

that avoiding currency overvaluation—and, in some cases, deliberately encouraging undervaluation—had helped develop a vibrant export sector. Of course, that was exactly the opposite of what had happened throughout most of Africa and Latin America, where, as noted in the previous section, the reluctance to adjust currency values, even in an environment of high domestic inflation, had resulted in significant real exchange rate overvaluation, losses in international competitiveness and eventually in very severe currency crises.

In the late 1980s and early 1990s a move towards economic reform swept through the developing world. This phenomenon had its origins in Latin America, and rapidly spread to other nations, including Central and Eastern Europe, the former Soviet Union, and India. This reform movement also affected Africa, although it moved at a slower pace, and faced stiffer opposition from the elites and those groups that during decades had benefitted from the planning approach to development and the vast amounts of official assistance provided by aid agencies to the region.

The early market-oriented reform agenda became known as the "Washington Consensus," a name that suggests that these policies originated in the multilateral agencies—the World Bank and the IMF—and in the U.S. Department of the Treasury. This, however, was not the case. In Latin America, for example, the reforms were largely homegrown, and were the response to more than ten years of a generalized crisis—the so-called "lost decade"—that had erupted in the early 1980s. An analysis of the relevant documents and archives shows that the Washington institutions were skeptical with respect some of the most daring reform proposals in many parts of the world, including in many of the Latin American nations. Moreover, in some cases and with respect to some polices such as pension reform, the Eorld Bank and the IMF were openly opposed.

In Argentina, Brazil, Chile, Colombia and Mexico, to mention just a few countries, reform programs were developed by local economists that had acquired significant political power. These economists-turned-politicians were often referred to as "technopols." Domínguez (1997, p. 7) defines *technopols* as follows:

> "Technopols are a variant of technocrats. In addition to being technocrats... technopols are political leaders (1) at or near the top of their country's government and political life (including opposition political parties) who (2) go beyond their specialized expertise to draw on various different streams of knowledge and who (3) vigorously participate in the

> nation's political life (4) for the purpose of affecting politics well beyond the economic realm and who may, at times, be associated with an effort to "remake" their country's politics, economics, and society. Technopols so defined may operate in either authoritarian or democratic regimes."

Of course, technopols don't come out of the blue. They are professional economists, academics, and members of think tanks that have participated in policy discussions for many years. Some of them even work in international organizations until they are called back to the country by politicians in a bind or by colleagues that request their input in drafting blueprints for reform. Possibly, the best known group of technopols are the fabled "Chicago boys" in Chile, a group of mostly (but not exclusively) University of Chicago graduates that led the design and implementation of Chile's reforms during the Pinochet dictatorship (1973-1990).[24] At one time or another, they held key cabinet positions, including the Ministry of Finance, Planning, Mining, Labor, and Economics, as well as the governorship of the central bank. But, of course, the Chicago Boys were not the only technopols with powerful cabinet positions during the Latin American reforms. Other "technopol" groups included the "Club Suizo" team in Colombia, the "MIT/Stanford group" in Mexico, the "IESA boys" in Venezuela, and the "Fundación Mediterráneo" group in Argentina.[25] Although technopols were particularly prominent in Latin America, they were not been restricted to that part of the world. They have also played important roles in Asia—the "Berkeley mafia" group in Indonesia—and in Central and Eastern Europe, where teams led by Leszek Balcerovic, and Vaclav Klaus played key political roles in Poland and the Czech Republic.

Surprisingly, in Africa there was an absence of "technopols." Of course, this doesn't mean that there weren't any professional economists that advocated reforms and participated in the war of ideas. There were, indeed, quite a few of them. However, in comparison to other regions, they were less influential. In Tanzania, for example, once an IMF program was signed in 1986 and the reforms were initiated, the technopols did not participate in the modernization

[24] Edwards and Edwards (1991).

[25] The leader of the Chicago Boys in Chile was Sergio De Castro, the Club Suizo group in Colombia was led by Rudy Hommes, the Mexican team by Pedro Aspe, the Venezuela reformers were led by Miguel Rodriguez, and the Argentine reformers by Domingo Cavallo. All of them had PhDs in Anglo Saxon universities, and all of them held very powerful cabinet positions during the heydays of the reforms. For a discussion of the role of ideas in the Latin American reforms see, for example, Edwards (2010).

process in cabinet or other senior positions. Bigsten et al. (1999, p. 21) have argued that during the late 1970s and early 1980s "the University of Dar es Salaam had generally been weakened—either by the socialist ideology or by opportunists within the institution who were eager to please the party leadership." This, they argue, "contributed to the lack of consolidation of intellectual policy groups within the Government or around it."

In a highly influential article published in 1989, John Williamson (1989) summarized the main goals of the Washington Consensus as follows:

- Achieve fiscal balance, as a way of reducing inflationary pressures, and stabilize prices.
- Target public expenditures towards the poorer groups in the population. Priority should be given to government expenditures aimed at improving social conditions and reducing poverty; generalized subsidies, which benefit mostly the middle class, were to be avoided.
- Implement deep tax reforms, in order to reduce evasion, increase government income and eliminate perverse incentives to production and investment.
- Modernize the financial sector. Interest rates had to be market determined, and not set by government officials in an arbitrary fashion. A well functioning capital market would help allocate scarce capital to the most productive uses.
- Avoid artificially strong currencies that discouraged exports. By staying away from currency overvaluation the probability of major, and very costly, crises would be greatly reduced. This measure would also encourage production in the agricultural sector.
- Reduce the extent of protectionism and rationalize trade policy. That is, the irrational structure of protectionism that had evolved over half a century—and that was documented above—had to be dismantled and replaced by lower import tariffs.
- Encourage foreign direct investment.
- Privatize inefficient state owned enterprises.
- Deregulate business transactions including investment decisions. Red tape had to be cut, barriers to entry in key industries eliminated, and competition encouraged.
- Improve legal protection of property rights, as a way of securing higher investment by both foreigners and nationals.

These ten policies—and the name "Washington Consensus" for that matter—acquired a life of their own, and were soon considered to be an official pronouncement of what the countries in the emerging world should do and what they should not do. As a result, a number of analysts have evaluated reform efforts through the lenses provided by this list, and, thus, have missed many of the subtleties and complexities of the actual individual country stories.

During the first half of the 1990s different nations emphasized different aspects of the market-oriented reforms. In some countries—and particularly in Latin America—results were quick and quite impressive. Inflation declined abruptly, exports increased, and real wages recovered at a rapid clip after having declined markedly during the "lost decade." But in many countries these early accomplishments hid important weaknesses: privatization of public utilities—including energy, water, sanitation, and telecommunications—was implemented without putting in place proper regulation and competition policies. As a result, in a number of cases state-owned monopolies were replaced by privately-owned monopolies, and in many instances privatization was surrounded by corruption and giveaways, where insiders—including government functionaries in charge of the public enterprises and of the sales' process—ended up buying large blocs of shares at conveniently low prices.

Also, most countries in every region of the world, failed to move forward in the creation of strong and modern institutions that would encourage the rule of law, protect property rights and reduce the extent of corruption. In many Latin American nations the situation was even worse, as policy makers used fixed (or rigid) exchange rates as a way of controlling inflation. With time, currencies became overvalued—a problem that, as noticed earlier, was well-known in Africa—and severe external imbalances developed.[26]

The end result of these inflexible exchange rate policies was a succession of currency crises that devastated countries from every region in the world, including countries that at the time had either embarked on the reform path and/or were considered as premier examples of outward orientation: Mexico (1994-95); Thailand, Malaysia, Indonesia, the Philippines, and South Korea (1997-98); Russia (1998); Brazil (1999); Turkey (2001); Argentina (2001-02); and Uruguay (2002). These crises resulted in significant drops in income, increased poverty, lower wages, and spikes in unemployment. In most countries the crises generated political upheaval,

[26] For details see, for example, Edwards (2010).

and in some they paved the way to populist politicians that reversed the reforms, nationalized foreign companies, and implemented protectionist measures—Argentina and Venezuela being the most salient examples. The crises also generated an intellectual backlash against the Washington Consensus. Chief critics of the simple version of market orientation and reform included Nobel laureates Joseph Stiglitz and Paul Krugman.[27]

A number of lessons on macroeconomic management emerged from the currency collapses of the 1990s and early 2000s. According to most authors the most valuable ones included the benefits of having flexible exchange rates, the dangers of short-term speculative capital movements—and, thus, the merits of some type of controls on short term capital mobility—, the importance of having a high level of international reserves, the value of labor market flexibility and openness, and the merit of countercyclical fiscal policies. There were also important lessons for social policies and governance, including the need to have an effective safety net to protect the poor and disadvantaged from the vagaries of the global economy. Other lessons referred to the importance of having a modern tax system that raised enough revenue to finance transfers to the poorest groups and to finance social programs.

During the second half of the 2000s most of these lessons were incorporated into specific policies in different countries; the process was gradual and without much fanfare. Many countries took a pragmatic approach towards reforms and modernization, discarded the rigid tenets of the Washington Consensus and moved towards their own versions of market and outward orientation. Overly doctrinaire positions were abandoned and whatever worked—including maintaining (majority) government ownership of some companies, and implementing some controls on capital mobility—was incorporated into the policy framework. In fact, many observers—including the critics of market-orientation and reform—didn't notice the extent to which many emerging countries had improved macroeconomic management. This became evident, however, with the collapse of Lehman Brothers in 2008. This time, things were really different. Instead of being the victims of contagion and crumbling, as so many times in the past, the emerging nations as a group continued to grow at a rapid pace. Emerging countries in Asia, Latin America and Africa showed remarkable resilience. These developments were helped by two important factors: high commodity prices, propelled by China's remarkable expansion, and significant liquidity in world financial markets. The latter was the result of the very permissive

[27] See for example Krugman (1995) and Stiglitz (2003 and 2008).

policies followed by the advanced countries' central banks—including the Federal Reserve's "Quantitative Easing" (QE) policies—and contributed to the strengthening of many emerging countries currencies.

IV. International aid: policies and controversies

Official assistance is a relatively new topic in economics. The classics—Smith, Ricardo, and Stuart Mill, for example—didn't address the subject in any significant way. In fact, if anything, classical economists thought that the colonies would catch up—and even surpass—the home country quite rapidly.[28] In Chapter VII of *The Wealth of Nations* Adam Smith provides a detailed discussion on the "causes of the prosperity of the new colonies." In many ways this analysis is remarkably modern. Smith argues that the main reason why the English colonies of North America had done significantly better than the Spanish dominions of South America was that "the political *institutions* of the English colonies have been more favorable to the improvement and cultivation of this land than those of the [Spanish colonies]."[29] This, of course, sounds remarkably similar to the ideas developed in the last few decades by Douglas North, Daron Acemouglu, James Robinson, Simon Johnson, and others. Smith goes on to list a number of policies implemented by the British—including tax, inheritance, and trade policies—that, in his view, explain the economic success in what was to become the United States; in parallel, he discusses how poor policies enacted by the Dutch and the Spanish—and to a lesser extent by the French—stifled growth and progress in their dominions. Although this chapter runs for almost 100 pages, there is not even a mild suggestion that the home nation should provide systematic financial assistance to its colonies.

IV.1 Early years

The first legal statute dealing expressly with official aid was passed by Parliament in the United Kingdom in 1929. The *Colonial Development Act* created the *Colonial Development Fund* with resources of one million pounds sterling per year. Although this Act intended to improve the social conditions in the colonies—especially in the rural sector—, its main objective was to promote British exports at a time when the overvaluation of the pound had greatly

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[28] The analysis in this section doesn't pretend to be exhaustive. I don't attempt to deal with every aspect of aid-related controversies. Readers interested in the intricacies of international assistance may consult some of the very thorough surveys on the subject, including two comprehensive articles by Radelet (2005, 2006) and Quibria (2014) and the extensive literature cited therein.

[29] Smith (1776), Cannan Edition, published by the University of Chicago Press, 1976. Emphasis added.

reduced British competitiveness.[30] Until the passing of this legislation the colonies were supposed to be, largely, self-financing, and any aid was confined to emergencies. In 1940 and 1945 new laws dealing with aid to the colonies were passed in the United Kingdom. These Acts increased the amount of funds available, and made commitments for longer periods of time—for up to ten years in the *Colonial Development and Welfare Act of 1945*. More important, the Act of 1945 established that aid plans had to be prepared "*in consultation* with representatives of the local population."[31]

The question of how much to involve recipient governments and populations in designing aid packages would become a recurrent theme in aid policy debates. Through time the terms used when referring to local involvement evolved from "consultation," as in the *Colonial Act* of 1945, to "participation," as in the influential Pearson Report in 1969 appointed in 1967 by George Woods, then World Bank president, "to study the consequences of development assistance." The first section of chapter 1 was titled "Crisis in Aid," indicating that, at least in the minds of some, official aid has been in crisis mode for almost half a century.[32]

In the United States the first law dealing with foreign assistance came quite late, with the adoption of the Marshall Plan in 1948.[33] In his inaugural speech on January 20th, 1949—the so-called *Point Four Speech*—President Harry Truman put forward, for the first time, the idea that aid to poor nations was an important component of U.S. foreign policy. He said that one of the goals of his administration would be to foster "growth of underdeveloped areas." He then added that "more than half the people of the world are living in conditions approaching misery… For the first time in history, humanity possesses the knowledge and the skill to relieve the suffering of these people."[34]

In spite of Truman's vehement allocution, aid commitments to poor countries were considered temporary. In 1953, when Congress extended the *Mutual Security Act*, it explicitly stated that economic aid to U.S. allies would end in two years; military aid was to come to a halt

[30] At the time the Act was passed, Sidney Webb—one of the founders of the London School of Economics and a prominent Fabian Socialist—was the Colonial Secretary. During his tenure as Secretary he fought, with limited success, to reinstate the policy of "native paramountcy" in East Africa. See Barder (2005) for a succinct history of foreign aid in the United Kingdom. The U.K. would devalue the currency and abandon the gold standard in 1931.

[31] Barder (2005, p. 3), emphasis added.

[32] See Pearson (1969).

[33] The Marshall Plan, which was announced by U.S. Secretary of State George C. Marshall in a speech at Harvard University on June 5, 1947, played an important role in defining U.S. policy towards foreign aid. Congress, however, was slow in passing the Plan. It was only done in 1948, after the Soviets took over Czechoslovakia.

[34] Truman (1949).

in three years. In the early 1960s—and largely as a result of the escalation of the Cold War—the United States revised its posture regarding bilateral assistance, and, jointly with other advanced countries, founded the Development Assistance Committee (DAC) at the newly formed Organization for Economic Cooperation and Development (OECD). The main objective of the DAC was—and continues to be—to coordinate aid to the poorest countries.[35]

During the early post World War II years there were recurrent discussions on whether aid should be allocated, mostly, towards projects geared at accelerating economic growth, or towards programs aimed at improving social conditions and reducing poverty. In the 1960s, and as the neoclassical model of growth developed by Solow made inroads in the economics profession, a greater emphasis was given to the formation of human capital and to projects and programs that encouraged productivity growth. The decision to move (somewhat) away from large, capital intensive projetcs was also influenced by the increasing evidence that the developing countries lacked the "absorption capacity" required to implement many of the aid projects. Training professionals and improving skills among the indigenous populations was seen as a key contribution to growth itself, as well as a step towards making aid more effective. It was not until the late 1960s and early 1970s that the "basic needs approach" became popular, and the improvement of social conditions became the central goal of the majority of official programs. The World Bank, under the leadership of former U.S. Secretary of Defense Robert S. McNamara, played an important role in the move in this direction.[36]

After World War II, most advanced nations followed a two-prong approach to aid. On the one hand they relied on their own bilateral programs, which were – and still are – run by national bureaucracies that often operated at the ministerial level; on the other hand, they supported the work of the multilateral organizations, such as the World Bank and the regional development banks. In addition, they used the OECD's DAC as a mechanism for achieving some level of coordination. This dual mechanism allowed most donor countries to be selective (in terms of which poor nations they assisted directly), and at the same time, to join forces with other donor nations in supporting broader initiatives. Throughout the years the Nordic countries have been

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[35] The original name of the DAC was Development Assistance Group, while the original name of the OECD was Organization for European Economic Cooperation. In 1946 France created its first aid agency (FIDES), which in 1963 was replaced by the Ministry of Cooperation. The Nordic countries created their own aid agencies in 1962.

[36] In some donor countries, however, the objective of alleviating poverty was central from early on. This was the case, for instance, of Sweden, where "Proposition 1962:100" explicitly established that the objective of aid was to raise the living standards of the poor.

particularly active in using this approach: through their own agencies (*Sida*, *Norad*, *Danida, Finida*) they have assisted a small number of countries—especially in Africa—, while at the same time they have devoted approximately 50% of their (quite large) foreign aid budget to support the multilateral organizations.[37]

Already in the 1950s and 1960s a number of market-oriented economists—including T.W. Schultz and Peter Bauer—argued against the provision of foreign aid beyond humanitarian relief. According to them, official assistance created the wrong incentives, especially when it distorted markets and encouraged protectionism. The response from early supporters of aid, such as W. Arthur Lewis and Paul Rosenstein Rodan, was that international aid supplemented domestic savings, and allowed poor countries to accumulate capital and develop a key manufacturing sector. In their view, rapid industrialization through import substitution was required in order to achieve sustained growth and reduce poverty. In the 1980s and early 1990s, and as views on foreign assistance changed, aid became more narrowly focused. The number of capital intensive projects was further reduced, and social programs were expanded; at the same time, aid became increasingly conditioned on certain actions by the recipient nations, including the adoption of market oriented policies and trade liberalization. During these years a large number of bilateral development agencies—including those in the Nordic countries and Japan—went through thorough evaluations of their programs, and decided that there was a need to be both more selective, in terms of which programs to support, and more demanding with respect to the recipient countries' contribution to their overall development strategy.

IV.2 The controversial role of the IMF, and "ownership" of aid programs

During the late 1980s and early 1990s the International Monetary Fund played an increasingly important role in defining overall aid policies. Its "seal of approval" was needed for other multilaterals to release their moneys. Fund conditionality was controversial, as more often than not it focused on devaluation, the elimination of subsidies, and the control of parastatals. The following extensive quote from President Juilus Nyerere from Tanzania captures the sentiment towards the Fund in many poor countries: [38]

[37] To be sure, the Nordic countries not always agreed with the specific policies undertaken by the multilateral organizations. In the early 1970s, for example, the Swedes were particularly critical of the World Bank's support to South Vietnam.

[38] Bulletin of Tanzanian Affairs, Issue 9, January 1980.

> "The I.M.F. always lays down conditions for using any of its facilities… But we expected these conditions to be non-ideological, and related to ensuring that money lent to us is not wasted, pocketed by political leaders or bureaucrats, used to build private villas at home or abroad, or deposited in private Swiss bank accounts. We also accepted that we could justly be asked how we were planning to deal with the problem in the medium or longer term. We could then have accepted or rejected such conditions; but we would not have felt it necessary to make a strong and public protest… Tanzania is not prepared to devalue its currency just because this is a traditional free market solution to everything and regardless of the merits of our position. It is not prepared to surrender its right to restrict imports by measures designed to ensure that we import quinine rather than cosmetics, or buses rather than cars for the elite. My Government is not prepared to give up our national endeavor to provide primary education for every child, basic medicines and some clean water for all our people. Cuts may have to be made in our national expenditure, but we will decide whether they fall on public services or private expenditure. Nor are we prepared to deal with inflation and shortages by relying only on monetary policy regardless of its relative effect on the poorest and less poor. Our price control machinery may not be the most effective in the world, but we will not abandon price control; we will only strive to make it more efficient. And above all, we shall continue with our endeavors to build a socialist society."

From here he went on to say:

> "…the I.M.F. … has an ideology of economic and social development which it is trying to impose on poor countries

> irrespective of their own clearly stated policies. And when we reject I.M.F. conditions we hear the threatening whisper: "Without accepting our conditions you will not get our money, and you will get no other money". Indeed we have already heard hints from some quarters that money or credit will not he made available to us until we have reached an understanding with the I.M.F. When did the I.M.F. become an International Ministry of Finance? When did nations agree to surrender to it their power of decision making?"

Throughout the 1980s a number of politicians and economists from around the developing world condemned the existing international economic order and demanded major reforms that would give Third World nations greater say on international issues. In many ways this anti-IMF sentiment was the result of the Mexican crisis and the insistence by the Fund that Mexico and other Latin American nations put their house in order – and implemented massive devaluations -- before receiving major assistance and debt forgiveness. Meetings criticizing the IMF and became common. Papers discussed in these fora had titles such as "The splendid isolation of the IMF," "The congenital inability of the IMF to deal with development problems," and "Swallowing the IMF medicine in the 1970s." One of the main complaints about the IMF was that it imposed policies without consulting the country in question, and without engaging in a deep policy dialogue.

In the late 1980s, however, the other Bretton Woods institution, the World Bank, began to move towards greater consultation with poor governments regarding aid programs. This was generally known as increasing the local degree of "ownership" of programs and aid initiatives. "Ownership," the Bank argued, would give aid and reform programs legitimacy and credibility, and would reduce the likelihood of resistance and reversion. A report on adjustment lending, released in 1988, pointed out that "progress in implementation has been stronger where governments have '*owned'* the program and hence were committed to carrying it through."[39] A 1991 evaluation of the effectiveness of reform programs argued that these had a low probability of success unless they were "clearly '*owned'* by the affected governments."[40]

[39] The World Bank, "Adjustment Lending: An Evaluation of Ten Years of Experience," 1988, p. 64.
[40] OED, "Annual Review of Evaluation Results," August 1990, p. 3.

Early World Bank emphasis on ownership was limited to its own operations, and focused on whether individual loans were successful. In an early attempt at exploring the links between ownership and loans, Johnson and Watsy (1993) analyzed more than 100 Bank operations in 42 countries. Ownership was defined using two criteria: the degree of intellectual support for the program in the country in question, and the extent to which key politicians pushed, from within the government, for the implementation of the program. Loans were classified in four groups that ranged from "Highly Satisfactory" to "Very Unsatisfactory." The overall degree of ownership was also classified using four-way criteria that went for "Very High" to "Very Low." In addition, four disaggregated measures of ownership were used: (a) whether the program was already in place when the loan was made (this was supposed to capture whether the program was originated domestically); (b) the level of intellectual support among policymakers; (c) political will to support the program; and (d) extent to which the government made an effort to generate political consensus in support of the program/loan. This study included one loan to Tanzania—an export rehabilitation loan from 1981 (loan TA-1133)—, which was granted at the time the economy was in free fall and the government had already broke up relations with the IMF. Not surprisingly, it was classified as having a very low degree of ownership, and a very unsatisfactory outcome. The overall results from this study supported the idea that, in general and across countries, a higher degree of ownership was correlated with a higher degree of success of Bank operations.[41]

With time the "ownership" issue went beyond the World Bank programs, and was also addressed by specific donors, including the Nordic countries. In 1995 Tanzania was one of the first countries to put in place a protocol for increasing the degree of ownership of aid programs. This was the result of a report by the Helleiner Commission, headed by Canadian economist Gerry Helleiner. According to this influential report, "ownership must mean that the final decisions rest with the recipient government."[42] It soon became apparent that involving the recipient government in the coordination and implementation of aid programs increased their acceptance and effectiveness. The idea soon spread to other parts of Africa and of the developing world.[43]

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[41] Of course, the mapping from degree of ownership to level o success was less than 100%. There were a number of operations that were "misclassified," in the sense of having very low degree of ownership and being highly successful, or having very high ownership and being very unsatisfactory.

[42] Helleiner (1995, as reproduced in Wangwe, 2002), p. 12.

[43] For recent discussions on the ownership of aid programs see Booth (2011).

In September 2000, the United Nations Assembly adopted the "Millennium Declaration" that set forward a new set of targets—the so-called *Millennium Development Goals (MDG)*—for the development community to be achieved by 2015. These goals included: (1) halving extreme poverty and hunger; (2) achieving universal primary education; (3) promoting gender equality, especially in the educational system; (4) reducing under-five child mortality by two thirds; (5) reducing the maternal mortality ratio by two thirds; (6) halting and reducing by one half the incidence of malaria, as well as halting and reversing the spread of HIV/AIDS; (7) ensuring environmental sustainability; and (h) developing a global partnership for development.[44] In March 2002, at the *Monterrey Conference* on development, most advanced countries signed a declaration that called for making "concrete efforts towards the goal of 0.7 percent of gross national product (GNP) towards official development assistance."[45] The focus on ownership and performance is mostly aimed at dealing with the "double principal agent" problem that has affected aid since its beginnings in the 1920s (see Radelet, 2006).

The Millenium Declaration and Monterrey Conference were subscribed by over 100 countries in the Paris Declaration on *Aid Effectiveness* of March 2005. Taking a cue from the experience of the late 1990s the Paris Declaration emphasized the recipient country's "ownership" of programs. There was also a renewed focus on linking aid to performance, governance and transparency. This new approach required developing a battery of tools to monitor whether specific projects and programs had "performed appropriately". Since the early 2000s academic economists have made important progress towards developing a methodology for evaluating whether social programs achieve their predetermined goals. Possibly the most important component of this new perspective is the use of "randomized field experiments." – see the discussion below. [46]

[44] See http://www.un.org/millenniumgoals/

[45] See *www.un.org/esa/ffd/monterrey/MonterreyConsensus.pdf*. The UN tracks progress towards achieving the MDGs by following 21 targets and 60 indicators. By mid 2012, and according to a report by the United Nations Secretary General, three of the eight goals—on poverty, water and slums—had been met for the developing world as a whole. At the same time, the data shows that most of MDG's would be missed in Sub Saharan Africa.

[46] For a discussion on the emerging "new aid model" see Bourguignon and Sundberg (2007). On randomized trial experiments see, for example, Banerjee and Duflo (2011).

IV.3 The inconclusiveness of econometric studies and the bitterness of recent policy controversies

Trough time, a number of authors—both in academia and in the aid community—have used a battery of econometric methods to analyze whether (or under what circumstances) aid is effective, in the sense of generating higher growth and better economic outcomes – see Guillaumont and Wagner (2014), and Quibria (2014) for comprehensive recent reviews.[47]

Some of these studies have tried to tackle issues of reversed causality, and have used a series of instruments—some more convincing than others—in an attempt to deal with the fact that slower growth (in very poor countries) may attract additional aid. Some works have analyzed whether aid only works under certain conditions, or whether a minimal degree of institutional development is required for international assistance to bear fruit (Burnside and Dollar 2000, 2004). These studies have considered nonlinear functional forms, and have investigated if there are meaningful interactions between aid and other variables, such as the degree of literacy, the level of corruption, the extent of macroeconomic stability, institutional strength, the quality of overall economic policies, and geography. The majority of these studies has used GDP growth as the performance variable of interest, have relied on cross-country or panel data, and have attempted to distinguish between short and long term impact.

Overall, the results from this large body of research have been fragile and inconclusive – Quibria (2014). After analyzing 97 studies, Doucouliagos and Paldam (2005) concluded that, in the best of cases, it was possible to say that there was a small positive, and yet statistically insignificant, relationship between official aid and growth. This conclusion was also reached by Rajan and Subramanian (2008) in an analysis that corrected for potential endogeneity problems, and that considered a comprehensive number of covariates. In particular, according to this study there is no clear relation running from more aid to faster growth; this is true even in countries with better policy environment and stronger institutions – see also, Rajan and Subramanian (2011).

Bourguignon and Sundberg (2007) have argued that one should not be surprised by the inconclusiveness of studies that rely on aggregate data. According to them, aid affects economic performance, directly and indirectly, through a variety of complex channels. Thus, treating all aid

[47] See, also, Johnson and Subramanian (2005), Rajan and Subramanian (2008), Collier and Dollar (2004), Bourgouignon and Saunders (2007), and Quibria (2014) and the literature cited therein. See Booth (2012) for a discussion on aid effectiveness and governace.

as homogeneous—independently of whether it is emergency assistance, program aid, or project-based aid—is misleading. In their view it is necessary to break open the “black box” of international aid, and deconstruct the causality chain that goes, in intricate and non-obvious ways, from aid to policymakers, to policies, and to country outcomes. This type of analysis would explore a number of specific ways in which international assistance could impact economic performance. In particular, according to Bourguignon and Sundberg (2007) it is important that studies that try to determine the impact of aid on growth consider issues related to technical assistance, conditionality, level of understanding of the economy in question, and the government ability to implement specific policies.[48]

In spite of its intensity, the academic debate pales in comparison with recent policy controversies on the subject. The level of animosity in this veritable war of ideas is illustrated by the following quote from a Sachs’ article published in 2009: “Moyo's views [are] cruel and mistaken… [Moyo and Easterly are] trying to pull up the ladder for those still left behind.”[49] Easterly’s reply, also from 2009, was equally strong: “Jeffrey Sachs [is]… the world's leading apologist and fund-raiser for the aid establishment… Sachs suffers from [an]… acute shortage of truthiness…”[50]

In a number of articles, as well as in a blog and in three bestselling books, Easterly has argued that aid agencies are bureaucracies that, in a typical monopolistic fashion, charge too much and deliver too little services.[51] Worse yet, according to him these agencies have formed a “cartel” that prefers “aid coordination” to “competition.” As most monopolies, aid bureaucracies innovate slowly and are overly risk averse. As a result, they have developed safeguards that avoid creative solutions to economic problems; the main goal of these bureaucracies is to steer clear of “failures.” But this is not all: according to Easterly and his supporters international assistance also suffers from a “double principal agent problem,” where those with the greatest interest in the success of the programs—aid recipients in the poor countries, and tax payers in donor nations—are far from the decision making process. As is often the case when the principal agent problem is severe, officials in donor and receiving countries tend to “capture” the aid organizations, and run them according to their own interests, values, and goals. Worse yet, states Easterly, many of the

[48] See Quibria (2014) and Edwards (2014) for alternative views on these issues.
[49] Sachs (2009).
[50] Easterly (2009, 2014).
[51] See, for example, Easterly (2002, 2003, 2006).

efforts to tackle this agency problem—including conditionality, consultation, and matching funds—have not worked, and have added to the bureaucracy. Easterly, Moyo and other aid-skeptics have vehemently argued that the official donor community uses the wrong yardstick to measure performance and success: instead of focusing on outcomes that are important for the poor, they emphasize the amount of funds spent in particular countries or regions.

Of course, most of the critics recognize that throughout the years the aid community has had some successes, including the improvement of health and education indicators in a large number of countries. But, overall, they believe that aid channeled through bureaucratic and monopolistic government agencies is largely destined to be ineffective and wasteful. At the risk of oversimplifying a bit, the view of aid critics may be summarized with the following quote from Easterly: "[F]oreign aid works for everyone except for those whom it was intended to help, with results such as the aids agencies' calculation that it takes $3,521 in aid to raise a poor person's income by $3.65 a year."[52]

During the last two decades or so, Jeffrey D. Sachs has become one of the most steadfast and vocal defenders of foreign aid channeled through official channels – see Sachs (2005) and the references cited there. Other prominent supporters of official assistance include Joseph Stiglitz and Paul Krugman. Their support, however, is not unconditional; as most economists that believe that official assistance funds should increase, they recognize that some reforms in the management of aid programs are in order. For example, Sachs and his colleagues do not defend traditional, top-down, bureaucratic assistance; on the contrary, their view is quite critical of the way in which aid has been dispensed in the past. But, at the same time, they strongly argue that, if properly provided, and if channeled towards combating particular ills—including diseases such as malaria and HIV-AIDS, the lack of potable water, and the inadequate infrastructure that isolates poor communities—, official assistance can help eliminate poverty in a relatively short period of time.

According to Sachs (2005) and his supporters—and there are many of them—most aid programs should concentrate on what they have called the "Big Five development interventions": improved agricultural inputs; investment in basic health—including antimalarial bed nets—; investment in education; the provision of power, transport and communication services; and making safe and drinking water available to everyone. When presented on their own, these

[52] Easterly (2002).

interventions are unlikely to generate excitement, enthusiasm, or optimism. Indeed, all of them have been fixtures of conventional development assistance for decades. What makes Sachs' view different, however, is the way in which assistance is to be provided. His is a holistic approach that begins with a community-specific diagnosis—what he calls "clinical economics"—, and the formulation of programs that capture the peculiarities of each community. Sachs' most important argument comes from the results obtained in a number of villages across Africa—the *Millennium Villages*—, where a modest amount of aid (about USD 120 per person, per year), coupled with the Big Five interventions have resulted, according to him, in significant improvements in agricultural output, reduced malaria cases, improved health, and better school achievements. However, and not surprisingly, the Millennium Villages Project (MVP) has had its critics. For example, Rich (2007) has argued that although the project has improved a number of indicators in the villages where it has operated, it has not solved some of Africa's most serious problems, including the domination of particular clans or tribes, corruption, dependency, and poor governance. A key question raised by these critics is whether the impact of the MVP will be sustained through time, or whether the communities where it has been active will revert to poverty and destitution once the aid workers leave.

To a large extent, the Easterly-Sachs debate has generated public attention because it has been couched in rather simple terms. These are simple narratives based on ethnographic arguments that resonate with large segments of the general public. But behind the different positions there are hundreds of academic studies—most of them based on advanced econometric techniques—that have tried to determine the extent to which foreign aid is effective. The problem, as noted, is that much of this body of empirical work has resulted in fragile and inconclusive evidence

For an increasing number of economists the issue of aid effectiveness is neither black nor white. Indeed, a number of authors have taken intermediate positions. For example, in an influential book that deals with the plight of the poorest of the poor, Collier (2009) has argued that both critics and staunch supporters of official aid have greatly exaggerated their claims and distorted the empirical and historical records. His analysis is based on a large body of empirical work undertaken by him and a number of his associates. Collier's reading of the evidence is that over the last 30 years official assistance has helped accelerate GDP growth among the poorest nations in the world—most of them in Africa—by approximately 1% per year. This is a

nontrivial figure, especially when one considers that during this period the poorest countries have had an aggregate rate of per capita growth of zero. That is, in the absence of official assistance, the billion people that live in these nations—the so-called "bottom billion"—would have seen their incomes retrogress year after year.

However, and as Collier points out in a highly convicting way, aid is subject to decreasing returns. Thus, doubling its volume, while maintaining the way in which it is disbursed, would not add another 1% to the squalid rate of growth in this group of countries. In order for additional aid to truly impact the lives of the bottom billion it needs to be reformed. Collier looks at this issue through the lenses of the four poverty traps that, according to him, have hampered development in these nations: the conflict trap, the natural resources trap, the landlocked trap, and the bad governance traps. His empirical results indicate that while additional official assistance can do little to free societies from the first two traps, it can be quite effective in addressing the problems arising from the landlocked and bad governance traps.[53]

Collier, however, believes that in order for this to happen there needs to be a major change in the way aid is disbursed. He is particularly critical of ex-ante conditionality—the type of policies used extensively during the 1980s and early 1990s—, and argues that technical assistance is particularly important in helping countries change course and move towards growth and progress. According to Collier's empirical analysis, aid is more effective when it is provided at the beginning (during the first four years) of a reform process leading to an economic turnaround. Also, official assistance would become much more effective if a larger proportion is devoted towards improving the skills of the local population, including those of government officials involved in the implementation of development programs. Collier also calls for creative solutions, such as aid agencies teaming up with civil society and NGOs to build parallel institutions to provide basic services such as education and health.

In a recent book, Banerjee and Duflo (2011) have argued that there is need for a "radical rethinking of the way to fight poverty." In their view, the acrimonious debate between the Easterly and Sachs factions has missed the boat. Banerjee and Duflo join a growing group of researchers in arguing that this controversy cannot be solved in the abstract, by using aggregate data and cross-country regressions. The evidence, in their view, is quite simple: some projects

[53] Collier (2009) does argue, however, that aid can be very effective in helping countries in the post-civil conflict period. See his discussion in pages 105-107.

financed by official aid work and are effective in reducing poverty and moving the domestic populations towards self-sufficiency and prosperity, while other projects (and programs) fail miserably. The question is not how aggregate aid programs have fared in the past, but how to evaluate whether specific programs are effective.

Banerjee and Duflo (2011) have urged that economists and other social scientists need to "think in terms of concrete problems that can have specific answers, rather than foreign assistance in general." They go on to say that "the lack of a grand universal answer might sound vaguely disappointing." This doesn't mean, however, that particular and circumstance-specific answers are not useful. In fact they are. Taking the lessons from concrete policies seriously would go a long way towards improving aid programs; it would help millions of people to get out of their poverty traps. Banerjee and Duflo have been among a group of economists that in recent years have introduced "randomized control trials" as a way of evaluating the effectiveness of different policy interventions.[54] In these experiments randomly selected individuals are subject to a treatment—they receive anti-malaria nets, for example—, while other randomly selected individuals conform the control group. A comparison of the outcome of this intervention provides evidence on whether the treatment is effective, and on the magnitude of the effects.

According to Banerjee and Duflo (2011) and Deaton (2010), among others, randomized control trials provide valuable information that can guide reforms and aid programs at the margin. Overall, their view is that "details matter." Poverty and underdevelopment are not so much the result of geography, politics or grand conspiracies that resulted in failed "institutions," as they are consequences of policies that go wrong due to their complexity, incomplete information, and missing markets. Official assistance, if properly provided, can make a huge difference; "small changes can have big effects." And, official aid, if properly disbursed, could finance a large number of effective "small projects." The key, then, is to know how to dispense official aid properly. In Banjeree and Duflo's world, evidence from randomized control trials is an essential tool for obtaining that knowledge, for using aid funds wisely, and, thus, for moving forward in the quest for reducing poverty.

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[54] The Poverty Action Lab at MIT, founded in 2003 by Banjeree and Duflo, has been on the forefront of the random trial experiment work. See for example Banerjee and Duflo (2009) and the survey by Deaton (2010), and the works cited there.

V. Concluding Remarks

Several conclusions emerge from this paper. In this final section I provide some reflections on three of them:

- First, in the last seventy years or so, academic research has helped shape international aid policies. During the early period (1950s and 1960s) the work of aid agencies was strongly influenced by the Harrod-Domar growth model and by W. Arthur Lewis' unlimited supplies of labor model. As a result, most agencies funded very large capital-intensive projects, and neglected policies, projects, and programs related to labor, human capital, and productivity. This situation changed slowly in the late 1960s and 1970s, with the ascendance of Solow's neoclassical model of growth, and the development of the "basic needs" approach to welfare economics. Aid policies changed focus, and a higher percentage of funds were devoted to social programs (health and education), programs aimed at directly reducing poverty, and programs that strengthened skills and human capital.

  Further changes in aid policy took place as a result of academic research that related openness and exports' expansion to productivity growth. In that regard, work undertaken by Anne Krueger and Jagdish Bhagwati was particularly important. As a consequence, during the 1980s and 1990s, international assistance became increasingly conditioned on the recipient countries liberalizing their economies through the elimination of quantitative import restrictions and the lowering of import tariffs.

  The development of the "dependent economy" macroeconomic model, with tradable and nontradable goods, in the late 1970s and early 1980s, helped put emphasis on the crucial role of the real exchange rate in the resource allocation process. Works by Robert Mundell and Rudi Dornbusch, among others, pointed out that real exchange rate overvaluation was costly and at the heart of devastating currency crises. These works, in conjunction with research undertaken by Robert Bates and Elliot Berg, among others, influenced aid agencies views regarding currencies, incentives, exports, and agriculture. Of course, the (very) poor performance of the agricultural sector between 1965 and 1985 in most regions – and

in particular in Africa -- also affected thinking in the aid agencies, and contributed to a new view that emphasized "getting prices right."

In the 1990s, two research lines influenced (directly and indirectly) aid policy. On the one hand, work on incentive compatibility and strategic behavior persuaded aid officials in donor countries to become more flexible, and to incorporate recipient governments in the design and management of aid programs. This new approach has received the name of "program ownership," and has been at the heart of improved relation between donors and poor nations in the last two decades. Also, in the late 1990s new research on capital mobility and the international transmission of crises, resulted in a more nuanced and pragmatic view regarding the use of capital controls. Many agencies – including the IMF and the World Bank – supported a limited use of capital controls (especially controls on capital inflows) and so-called macro-prudential regulations, as a way of avoiding destabilizing forces, and currency crises.

- A second conclusion is that when evaluating aid effectiveness, it is important to make several distinctions: what time periods are we talking about, which country we are referring to, and whether we are talking about aid-financed projects or aid-supported programs.

In this paper I have shown that aid policies have evolved significantly through time. They were very different in the 1960s than in the 2000s. Bumping several decades together when analyzing these issues – as it has been done in many econometric studies – makes little sense and is likely to generate misleading results. In the early years aid was a top-down activity, with little consultation to local authorities or the local population, and almost no coordination across agencies. Large, wasteful, capital-intensive projects – so called "white elephants" – were usually financed at an enormous cost; many of them worked poorly – or, simply, never took off – and had extremely low (social) rates of return. This changed through time. Today, for instance, there is frequent consultation with the local authorities, aid agencies coordinate their work through the DAC, and there is an increasing concern about the views and opinions of the civil society, including their views on the environmental impact of different investments. Moreover, there is an increasing effort in every region to evaluate the effects of different projects and programs. Many of

these evaluations are done using recently developed techniques based on "randomized control trials." There is little doubt that aid has become more participative, and has been geared towards smaller projects and programs. Moreover, involving the civil society and NGOs has had an effect on accountability and has helped reduce – although not eliminate – corruption and malfeasance.

It is also important to distinguish between projects and programs. Perhaps the greatest mistakes by aid agencies, including the World Bank, were made in the 1960s and 1970s, when they supplied massive funds to many poor nations that were pursuing the wrong policies and that, by doing so, were impoverishing their peoples. Worse yet, aid agencies were largely silent regarding policies and initiatives that in country after country contributed to the demise of the agricultural sector and violated peasants' civil and human rights.[55] The Nordic agencies (*Sida*, *Norad*, *Danida, Finida*) played an important role in these stories; from early on their senior officials were very enthusiastic about many of the African leaders' quests to implement socialist regimes with varying degrees of local flavor. As it turned out, none of these policy views worked; in fact, they had devastating consequences for local populations.

Tanzania provides a stinking example of the aid agencies support of erroneous policies. Indeed, and as I argue in Edwards (2014), the country's history would have been very different if it weren't for the massive amount of funds and millions of man-hours of "technical assistance" provided by different official aid agencies. Without the generous support of the World Bank and the Nordic countries, the Arusha Declaration – the program that guided the policies of self reliance and African Socialism – would have been nothing more than a vehement manifesto by president Nyerere. It is likely that Parliament would have approved some of the basic policies, including the nationalization of banks and trading companies, but it would have been unable to put to work some of Nyerere's most ambitious ideas.[56] The villagization program, for example, was only possible thanks to the ample availability of international

[55] When these agencies did speak up, it was rather late. See the 1986 book by Boesen, Havnevik, Koponen, and Odgaard (1986) for a somewhat critical assessment of the Nyerere policies from 1965 through 1985.

[56] Also, it is unlikely that Nyerere would have pushed ujamaa and self-reliance as hard as he did if the U.K. and the Federal Republic of Germany hadn't cut aid in 1965-66.

assistance—it is very expensive to forcefully move 13 million people into new villages. The same can be said about the rapid expansion of parastatals, whose huge deficits were (indirectly) financed by the official aid community. Of course, international assistance also funded some worthwhile social projects, including the expansion of educational services, an achievement that made Nyerere justifiably proud. But having encouraged education and health provision doesn't excuse the aid community from having contributed to an experiment that lasted for too long, was way too costly, and resulted in significant hardship for millions of people.

But, as I showed in the body of this paper, in the 1980s there was a marked change in most aid agencies approach to policy and aid provision. There was a recognition that incentives mattered, that large projects were not always desirable; there was also a new emphasis on the need to open up trade and take advantage of the opportunities of the global economy. Tanzania again provides an example worth emphasizing. Starting in (approximately) 1985 the same agencies that had approved and financed the policies of African Socialism and had failed to sound the alarm bell when things went drastically wrong, became increasingly concerned about the country's direction. The re-evaluation of aid programs in the donor countries, the realization that the Tanzanian people were facing major penuries, the shifting political winds in the USA and the UK, and the findings from new research—including Robert Bates' book and the Berg Report—resulted in a change in strategies in most official aid agencies. There is little doubt that the decision by the Nordic countries to drastically cut assistance in 1983-84, and to insist that major policy rectification had to be implemented, played a role in Nyerere's decision of not running for reelection. Starting in late 1985 the official aid agencies behaved very differently from the way they had done it in the past. Now it was "tough love." Changing course was for the good of the country and its people. Devaluing the currency was painful, but it was needed to relax the draconian foreign currency constrain that was asphyxiating the nation. Aid would only return to previous levels if reforms were enacted. That was the new position, and that is what eventually happened. Of course, Tanzania's experience is not unique; similar stories could be told about a myriad of nations from around the world.

- The third conclusion that emerges from this paper, and probably the most important one, is that international aid affects recipient economies in extremely complex ways and through multiple and changing channels. The discussion presented here also underlies that fact that this is a two way relationship: aid agencies influence policies, and the reality in the recipient country affects the actions of aid agencies. This relationship is so intricate and time-dependent that is not amenable to being captured by cross-country or panel regressions; in fact, even sophisticated specifications with multiple breakpoints and nonlinearities are unlikely to explain the inner workings of the aid-performance connection. Bourguignon and Sundberg (2007) have pointed out that there is a need to go beyond econometrics, and to break open the *black box* of development aid. I would go even further, and argue that we need to realize that there is a multiplicity of black boxes. Or, to put it differently, that the black box is highly elastic and keeps changing through time. Breaking these boxes open and understanding why aid works some times and not others, and why some projects are successful while other are disasters, requires analyzing in great detail specific country episodes. If we want to truly understand the convoluted ways in which official aid affect different economic outcomes we need to plunge into archives, analyze data in detail, carefully look for counterfactuals, understand the temperament of the major players, and take into account historical circumstances. This is a difficult subject that requires detective-like work.

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