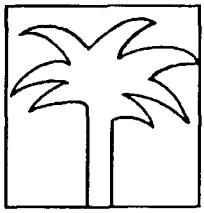

Back to first principles: project design as the best defence against aid addiction*

A.V. Hughes

What's the problem?

In the last forty years, the giving and receiving of foreign aid has become, for millions of people, a way of life—a source of earned incomes and rents, a form of economic activity in itself. A whole generation of aid donors and recipients has grown middle-aged and older in varying degrees of aid-financed comfort. Aid has become a wide and rewarding field of study for teachers and researchers. It has evolved into a vast source of patronage, power-broking, the making of corrupt payments and the sale of goods and services at uncompetitive prices. And it has become the mainstay of governments that would otherwise have been overthrown by their long-suffering people, or would have collapsed through incompetence and avarice.

Rather like a foreign war, the receipt of foreign aid keeps people busy, even happy, and masks the inadequacies of other measures supposed to be generating foreign exchange earnings, or improving the ratio of domestic savings to investment. Governments in receipt of relatively large amounts of aid are likely to be unrealistic, and less effective, in their efforts to bring about sustainable growth based on private sector initiatives and capital. Their dependence on aid will tend to be self-perpetuating through the deficiencies in the other policies that aid permits.

A particularly clear example is the way strong inflows of foreign aid exert a baleful influence on exchange rates. If a large part of a country's foreign currency needs is being supplied regardless of the exchange rate, there is much less pressure on the authorities to allow the exchange rate, as the price of foreign exchange, to reflect its open-market scarcity, and so to reward those who are net earners and savers of foreign exchange adequately—usually the rural sector. Indeed the government may be almost unaware of foreign exchange constraint, though its central bank may have a much clearer perception of reality. Exchange rate depreciation is often frowned on by governments for 'macho' reasons (who wants to admit to owning a weak currency?) or to avoid retail price increases. Anything that lets a government turn a blind eye to the need for a realistic exchange rate will incur heavy costs in misallocation of resources and the penalizing of just those sectors (agriculture, local manufacturing) where the seeds of sound economic growth should be nurtured.

Clearly it was not meant to be like that. The proclaimed aims of aid donors and recipients refer to faster economic growth, reduction of poverty, better education and health, and, increasingly, conservation of the environment. The diversion and abuse of aid flows is inefficient in terms of the expressed objectives of donors and recipients; but it is not so clear that it is inefficient in terms of a more complex and unpublicized set of aims. In some countries, one-third of the nominal value of aid flows is estimated to be syphoned off in 'unofficial' payments to people other than the target beneficiaries.

Nor do national governments, whether donors or recipients, have any great interest in the diminution of aid flows in total, or the proportion going to governments. They may pay lip-service to ideals of reduced reliance on aid. Donor governments play off pro-aid and

* This paper is an edited version of a paper presented at a symposium on development aid organized by the Centre for Area Studies, Tamkang University, Taipei. It is written in a personal and unofficial capacity, and the opinions expressed in it do not necessarily reflect the views of the Solomon Islands Government or Central Bank.

anti-aid lobbies in order to stay in power, rather than to achieve any particular developmental outcome. Recipient governments may noisily snap at the hand that feeds them, to show their political independence. Yet, they like these transfers which put foreign savings in the hands of the government (and so far nobody seems really to question that), when the domestic savings for which these transfers are substituting would have been in private hands (the savings of hundreds and thousands of households and business firms) and hence that much more difficult to steer into the Treasury and apply to government purposes.

Of course there are real achievements. Much aid is keenly priced and honestly handled, and many projects funded by aid have had a positive impact on output, incomes and welfare. Substantial aid programs exist just to keep deprived people alive or to rescue them from the results of natural or political disasters. However, even these humanitarian efforts are not proof against parasites. Aid flows are so large, and the manifest inefficiencies so widely reported, that it must be worth examining how the problem of malfunctioning may be tackled, by donor and recipient alike. A shift of 20 per cent of aid flows from the misdirected to the well-managed category would mean a huge improvement in the absolute net benefits of aid. It is not that we do not know better. Sound methods of identifying, appraising and implementing projects have been known and taught for three decades. We seem to have lost the way.

Human nature is a large part of the reason for underperformance of aid flows. A variety of people are gathered around the aid delivery line. Their efforts are applied to diverting the benefits of aid to themselves—to make them richer, if they already have wealth; to entrench themselves in power, if they are in a position to do so; to improve their economic security, if that is in doubt. We should recognize this and design aid flows as far as possible to reduce the likelihood of this form of hijacking.

We should make sure we have the right goals clearly in view. This is not as simple as it sounds. Under political, commercial and social pressures it is only too easy to embrace muddled, conflicting, even unachievable, objectives. The best way to avoid that is to return to first principles: to recall why aid exists, why it began in the first place; and to resurrect the essential aims of aid, as a concept of economic theory, to provide the criteria against which aid programs and projects are chosen, designed and carried out.

What is aid?

Aid is a non-commercial transfer of resources from one economy to another, when commercial flows are inadequate to achieve some desired combination of growth and stability. Aid originates in the perception that a poorer economy, in which income from production of goods and services falls short of the combined needs of consumption and investment, can be helped by short-term transfers of resources on non-trade terms towards a medium-term equilibrium that will be sustainable by trade. These transfers take the form of investment goods, or the foreign exchange to purchase such goods, or infusions of skilled labour, or, more rarely, essential consumption goods to release domestic resources for investment. The same analytical justification applies to humanitarian aid; it differs only in the weighting attached to the short- and long-term costs and benefits.

Aid aims to balance three basic relations:

(1) Supply and use of real resources, where domestically produced and imported goods and services (M) are used in consumption (C), investment (I) and exports (X), expressed as:

$$GDP + M = C + I + X.$$

(2) National disposable income and expenditures, where earned domestic incomes, plus foreign grants, cover expenditure on domestic production of consumption and investment goods, and the current account of the balance of payments, expressed as:

$$GDP + Aid = C + I + (X - M).$$

(3) Savings/investment and balance of payments current account, the excess of investment expenditure over domestic savings (S) is equal to the deficit on current account expressed as:

$$C + S = C + I + X - M, \text{ and so,}$$

$$S - I = X - M.$$

The rationale for aid arises from two perceived chronic deficits.

First, domestic savings are inadequate to finance the level of investment required for economic growth. This may be the case if the deficit is particularly severe when the government and its attendant activities are heavy users of domestic savings for non-investment purposes. In this case, foreign transfers are required in the form of

commercial loans or direct investment. If these are inadequate, official machinery is brought into play to transfer foreign resources as aid.

The second perceived deficit occurs when foreign exchange outflows (to pay for imports of goods and services) exceed the sum of inflows from export earnings and private capital in the form of long-term debt and direct private investment. In this event, donor governments and international institutions make available foreign exchange to support import expenditures.

These two gaps, the savings/investment gap and the foreign exchange gap, are the justification for all forms of economic aid, no matter what sector it goes to. An economy that generates sufficient domestic savings to cover its investment needs has no cause to seek foreign aid. Nor does an economy whose balance of payments deficit on current account is matched by capital flows on commercial terms which the country is prepared to accept. Such economies can purchase their needs on the open market, unrestricted by the complexities and uncertain economic effect of aid; and they can allocate the resources generated by their own activity to their own social and environmental needs (and even become aid donors).

A further justification for foreign aid, which is worth highlighting as a separate concept even though it derives ultimately from the savings/investment deficit, is a shortage of technical skills. This handicaps many developing countries' efforts to increase output and so to narrow the domestic and external deficits. Because the forms of aid aimed at improving skills (now known, alas, as human resource development, or HRD), are all to do with people—their spirit, knowledge, motivation, and view of life—they deserve special attention in the efforts to prevent the hijacking of aid and in reducing its distorting effects. The improvement of skills can be seen as a transfer of real resources, that is, knowledge, to fill that part of the domestic and external deficits attributable to a lack of value-adding activity in the processes of economic output.

These economic functions of the 'aid forest' are often forgotten among the trees and undergrowth of aid administration.

Aid is usually presented as transient, in both donor and recipient countries. Almost universally, part of the aid rhetoric is still that an economy's dependence on aid should, over an appropriate period, diminish. Achievement of this aim, known in the jargon as 'weaning', is uneven. Such aspirations are frequently expressed by both donors and recipients, but in some cases the statements have acquired a hollow ring. For some recipients, such as the tiny atolls or the disaster-prone poorest countries, it is hard to see how aid could be cut back without an unacceptable amount of deprivation; for others, endowed with a better balance between population and natural resources, the ending, or at least the reduction of dependence on aid, is a real, if elusive, possibility.

If an attitude of perpetual dependency has taken root; if no substantial reduction in the need for transfers in place of domestic savings is foreseen; if the donors and recipients agree on a permanent relationship through which resources are transferred indefinitely; then the need for justification and accounting for aid flows can be considerably revised. Aid can then form a permanent inflow to the pool of foreign exchange available to the recipient government to spend as it sees fit, provided its broad policies and principles accord with its permanent relationship with the donor. The methodology of negotiation, pricing and project appraisal may be revised, or in some areas, abandoned.

This is not the basis on which most aid is presently given and received. The theory of aid is that its appropriate use leads, over a period, to its being no longer required. In this scenario, domestic savings rise to a level where government-to-government transfers are no longer needed to bridge the savings/investment gap and sustainable inflows of commercial capital become sufficient to cover any current account deficit in the balance of payments. Though there have been many setbacks, there are enough cases where this has happened, several of them in Southeast Asia, to make the continued statement of independence from aid a plausible ambition for many of the better-endowed recipients.

The importance of project design

For such countries, therefore, projects and programs should be accepted, designed and operated with the three-fold economic aim of aid continually in view:

(1) Foreign exchange: making foreign exchange resources available in such a way that:
   (a) the external deficit is bridged, and the reserves conserved, to enable consumption and investment to proceed over the medium term;

(b) net foreign exchange earnings are increased on a sustainable basis to a level where aid is no longer required.

(2) Domestic savings: inducing changes in output/incomes and expenditure patterns so that domestic savings finance a greater proportion of domestic investment—this, too, on a sustainable basis, though of course inflows of foreign private capital may continue to finance investment as well.

(3) Domestic skills: raising the level of skills in the economy so that value can be added to all kinds of output, and problems of management—including aid programs—can be handled successfully by the domestic workforce.

It follows that all ideas regarding foreign aid, all donor contacts, programming missions, project proposals, and 'institutional reforms' should be subjected to a test that may be related to the degree to which they satisfy these 'Three Basic Criteria'.

As the advocates of any proposal will answer 'yes' to all these criteria, the appraising questions also have to be asked:

how? when? for how long? by how much? at what cost?

By insisting on answers to those questions, and selecting only the high performers, programs can be devised for the use of aid that reflect its philosophical roots and offer the best chances of resisting hijack and abuse—including those forms of abuse that lead to more pervasive and ineradicable dependence on continued flows of aid.

On the basis of the Three Basic Criteria, a recipient country can exercise a very substantial and positive influence on any project's ratio of economic and social benefits to costs. The impact of the criteria can be analysed under the headings:

- specification and design;
- appraisal of costs and benefits;
- procurement of goods and services;
- staffing and operating.

Specification and design

The scale and technology of the project must fit the country, the product and the market. This will usually mean smaller projects using more locations and more people than would be the case in a developed country. It will mean that imported materials and technology are used where costs are substantially lower, or there is no practical alternative (for example, in data processing or telecommunications), but not where the margin is narrow or where domestic prices are lower than import costs (for example, in construction, natural resources development, health and education). Hygiene and environmental standards must be high, but capital intensity should be as low as is compatible with an effective and competitive product.

If the output of traded goods is increased and import demand for close substitutes reduced, net foreign exchange earnings will rise. If incomes, profits, and retained earnings are increased by increasing value added, by raising levels of skill and by reducing lost production through ill-health, the savings ratio will be improved. By providing foreign teachers to enrich local workers (and with incentives to learn from them), skills will be raised.

Appraisal of projects

In some countries, particularly the smaller ones, the glamour seems to have gone from project appraisal. A generation of project planners grew up in the late 1960s and early 1970s on a diet of Little and Mirlees' *OECD Manual* (or, if that was too strong, slightly diluted and re-flavoured versions of it), circulated by the World Bank and other institutions. Above all, the constant reference back to border prices, and foreign exchange as the numeraire of value, provides an acid discipline to the development planner working at micro or project level.

The scarcest commodity for a developing economy is uncommitted, untied foreign exchange. That is, the kind of foreign exchange that is earned and made available for re-investment through the banking and fiscal systems of the economy, by successful commercial enterprises in the traded goods sectors.

It follows that projects must be appraised on these concepts. For example, hard-nosed shadow pricing of building materials and associated labour costs will usually show that it is economically better to build in relatively short-lived local materials than in 'harder' and more technologically advanced imported materials. Realistic discount rates and exchange rates will often show that future recurrent costs of maintenance of local-materials buildings are lower, in present value terms, than those of high-tech. buildings. The same goes for ship design and construction and some forms of road transport. However, for most of us, aircraft are in the 'no practical alternative' category, but there should be as few of these as possible.

Procurement of goods and services

Increased demand for locally produced goods and services will also have a multiplier effect, boosting domestic incomes and encouraging savings. When domestic sources are inadequate, but capable of being developed at rational shadow prices, they must be built up. Specifications for aid projects, having been written so that they can be met by local firms—even if they have to incorporate foreign expertise to do it—must then be implemented by intelligent, and hard-headed, procurement and contract supervision. Nobody is made better off by shoddy work. The aim is to permanently improve output, narrow the foreign currency gap, improve the domestic savings ratio, and transfer skills.

Staffing and operation

There are two obstacles to development associated with many aid projects. First, aid projects are notoriously afflicted by the ills of bureaucracy. Even projects that are let out to implementation by contract seem to be affected by excessive and inaccurate paper work, indecision, changes of direction and location, and sometimes change of government and cancellation on grounds more political than economic. The standard of care and accountability of recipient governments for aid-funded projects is often worse than for their own recurrent operations, and in many countries the reports and accounts promised so readily in aid negotiations make their appearance many years late, if they appear at all. The remedies lie partly in more energetic enforcement of existing rules, by recipient and donor alike, and partly in keeping to a minimum the number of projects that have to be staffed and operated by civil servants.

A second obstacle is 'demonstration effect' of the income and consumption patterns of foreign staff on their local colleagues—now a well-known facet of the aid business. Foreign staff should be kept to the minimum needed for training and operation. They should be chosen carefully and required to set an example of hard work. The bulk of their remuneration should be paid outside the country at the termination of their contracts and non-essential expenditures should be subject to high marginal rates of tax.

How much difference would it make?

If we were successful in these endeavours, what kind of aid-financed expenditures would we see? If the Three Basic Criteria were applied rigorously, what would be the hallmarks of the consequent aid projects?

In the renewable natural resource sector—in agriculture, fisheries, forestry—there would be more emphasis on smaller, more easily managed production units and the development of production and processing technology for that 'localized' scale. Research and development would focus on finding technology and adapting it to smaller units, but without departing from export-competitive standards of hygiene, physical quality, accuracy of measurement and cost of production and transport.

In the construction and infrastructure sectors, there would be greater emphasis on the use of locally available materials and skills, and the adaptation of existing products and techniques to serve modern needs. Realistic pricing of local and imported products will narrow or even eliminate any initial apparent cost handicap for local products. The design of commercial and domestic buildings, roads, civil works of all kinds, would be extensively re-jigged to increase substantially the relative importance of local, as against imported, materials and technology.

In the social services of education and health, there are obvious consequences for both the 'hardware' and the 'software' aspects of their activities. Curricula would give greater prominence to teaching ways and means of narrowing the foreign currency gap and improving the savings ratio. Activities and attitudes that did so would be encouraged. Since the route to both those goals is through increased domestic production and higher business and household incomes, this emphasis on home-grown values should not clash with other aspects of the curriculum.

Medical services would stress the importance of preventive rather than curative measures, because of the much higher domestic expenditure content of public health activities compared with what goes on in hospitals. In both education and health, the increased emphasis on locally-produced building materials and techniques would reduce both the technological complexity and construction cost of educational institutions and hospitals. The classic blunders of enormously expensive institutions would be avoided. They alienate their inmates from the physical reality of normal life, pose huge maintenance problems when anything goes wrong, and do nothing in a cost–benefit sense for the health of patients or the learning of students. Further, as total aid is limited, emphasis would be shifted from exotic expenditures on ostentatious structures to

realistic expenditure on teaching supplies and relatively simple medical equipment.

There is nothing original in the approach advocated here. Plenty of people have thought of it, and many are trying to put these ideas into practice. All this was seen and documented twenty years ago by the Pearson Commission; but the problems have turned out to be enduring. Achievement so far falls well short of the substantial, albeit gradual, transformation of the aid effort that will have to come if performance is to satisfy the Three Basic Criteria.

Why is it not happening?

Why is the silent perversion of aid, into dependence-perpetuating forms of economic activity, continuing? Partly out of habit. Partly out of laziness and lack of a sense of urgency. Yet, these attitudes can be shifted. Change is resisted because of the widespread coincidence of interest, and the pervasive receipt of benefits from having things the way they are now. The emergence of new aid donors, including some who were previously aid recipients, along with signs of aid fatigue among the older donors, means that new people, new flows of hijackable resources, are coming into the aid marketplace, offering the older and craftier players fresh scope for diversion of slices of this well-meaning effort into unpublicized purposes.

Undoubtedly some of the relationships in the aid business are corrupt, in both donor and recipient countries. It would be most untypical of human nature if such large flows of resources, involving so many handling stages and such intrinsic difficulties in keeping stock and accounting for them, did not result in some degree of over-pricing, kick-backs, under-supply or outright theft. The legitimate, or at least not illegal, set of mutually beneficial arrangements that surrounds and feeds on the aid industry is just as troublesome and more difficult to confront.

The main interest groups that depend, in varying degrees, on aid flows for their sustenance are:

Aid administrators

Teams of bureaucrats in donor and recipient countries earn their reasonably comfortable living by managing aid flows. They establish norms and procedures, set up departments, negotiate budgets and programs, and contemplate many important-looking files and reports. They also deal with consultants and suppliers, and with other bureaucrats at home and abroad, in numerous meetings. This feels good; and while upheavals take place from time to time, usually for political reasons, most people within the aid bureaucracies are not keen to disturb an assured and prestigious pattern of activity. It is unreasonable to look for much sustained effort for change, especially of a more rigorous and uncomfortable kind, from within the aid machine.

A much smaller army of non-government organization (NGO) administrators and field workers has grown up alongside the officials of donor and recipient governments. Often they can position aid resources on target with more precision and lower overhead costs than the official aid machine. Distinctive in style and appearance from their civil service cousins, NGO aid personnel derive much of their morale and effectiveness from these palpable differences. They are valuable advocates of more effective aid, even though in some cases, they concentrate on objectives such as saving souls, that have little relevance to materialistic or spiritual values. They actively devise better field techniques and mobilize the aid lobby in donor countries. It is very important that they should not lose these positive characteristics as they get bigger and older, acquiring bureaucratic features of complexity and rigidity, slow response and rising overhead costs. There is an obvious paradox in the often critical stance of NGOs vis-à-vis official aid programs, and their increasing use of resources made available to them from official institutions. The London-based Overseas Development Institute commented recently that the danger posed to NGO effectiveness by the 'encroaching embrace of governments and official donors' is a real one.

Politicians

Most aid is still given by one government to another government. Reports of the Organization for Economic Cooperation and Development's Development Assistance Committee show that world-wide, out of total annual official aid flows of US$50 billion in 1987, of which over one-third went to Asian and South Pacific recipients, only one-quarter passed through the multilateral institutions as grants or capital subscriptions. The proportion rose in the 1970s to 30 per cent, but dropped back in the 1980s. Official aid flows are two to three times bigger than private direct investment, and 10 to 15 times bigger than the flows handled by NGOs.

Strategic and economic leverage can be better exerted through bilateral programs: aid is very often linked to preferential access to the recipient's natural resources (fish, minerals), markets or sites for military bases. The South

Pacific region offers shining examples of such linkages. Both the giving and the receiving are opportunities for politicians to earn applause for their generosity, statesmanship, economic vision and so forth. In the awarding of contracts to supply equipment or services, the donor government bestows patronage on its depressed industries or on corporations that have assisted with the ruling party's expenses. In deciding where the benefits of aid will be distributed, the recipient government rewards its supporters, punishes its opponents, and generally furthers its ambition to stay in office as long as possible. By assigning high-profile development projects to aid programs, recipient governments are able to conserve their 'own' resources for projects of more doubtful developmental value, such as arms purchases, government facilities or public service pay. This is not a caricature—it happens. The political patronage factor is very strong in aid management. Few aid administrators are strong enough, at the giving or receiving end of the line, to buck the wishes of the politicians, even when these are clearly sub-optimal in achieving the expressed aims of the aid program.

This was a main reason for the efforts made, over many years, to multilateralize and de-politicize aid flows, by putting more of the aid through institutions such as the World Bank and the Asian Development Bank (ADB), and nominating non-government organizations such as Save the Children Fund and Oxfam as intermediaries or executing agencies. These organizations try to use objective expertise, and offer resistance to the more blatant hijack methods. Aid handled by NGOs is equivalent to 10 per cent of all official aid flows, and the bigger NGOs have built up considerable expertise in getting their aid where it is supposed to go. But governments became uncomfortable with this because their power to fine-tune the patronage was eroded. From Mrs Thatcher to Colonel Qaddafi, the donors have a preference for bilateral giving, the kind of aid you can put a donor's label on (not always an unmixed blessing, when one looks at some of the rusting junk and half-built projects bestowed on developing countries under bilateral programs—but political memories are short).

Recipient governments have not been too enthusiastic with moves to channel large amounts of bilateral aid through the hands of NGOs. In many developing countries, NGOs are active in stimulating more informed discussion of economic and political issues, not always to the government's comfort.

Manufacturers

The manufacturers of goods to be bought with aid are mainly located in the donor country, or—more rarely—in other industrial economies. There has been little interest in the development of manufacturing in the aid-receiving countries, other than in highly-protected import substitution. Some will see opportunities for the export of capital, machine tools, and know-how, to developing countries to establish profitable subsidiaries or markets for their capital goods. However, most are concerned only to sell the output of their existing enterprises, and to have it paid for by their own governments in a comfortingly assured way, under an aid program. While relocation of manufacturing plants into developing countries is a common phenomenon, it is done for market access and cost advantage, not as a spin-off from aid programs. Moves to unbundle aid-financed technology, to make more use of local firms in the manufacturing process, are unlikely to meet widespread support from donor country industries.

Service industry

The financial institutions of the donor countries find some worthwhile pickings in the aid business, though it is small beer compared with the financing of normal trade and commercial investment, and they are mostly wary now of getting drawn into any exposure to debt of developing countries. Consultant services are much used by aid programs, and many firms of economic, engineering, agricultural, transport, education and, increasingly now, environmental consultants, have built up substantial and well-remunerated practices by plugging in to flows of aid. It is a common complaint among recipients that huge portions of an agreed aid program go to pay consultants from the donor country, many of whom are less than fully effective. While the more far-sighted consultant firms are trying to establish local contacts for more cost-effective field work, the bulk of these payments continue to go back to the donor country. There will be no great enthusiasm for the diversion of cash flow to local consultants.

The results

What is wrong with all this, as long as it somehow gets the projects done? Isn't it better to accept that a bit more must be paid to use the donor country's contractors, put the aid where the politicians say, and miss out on a few over-sophisticated refinements of project appraisal? At least, the project gets done, on

time, on budget, and it will work the way it is supposed to.

The truth is that aid projects, done the way they are done now, with technological and psychological dominance of the donor, come in over budget, late, in the wrong place, prone to frequent breakdowns and with unaffordable maintenance costs. They also bring a raft of additional and more enduring problems because of lack of attention to the Three Basic Criteria.

Aid projects that ignore the Three Basic Criteria have the effect of suppressing local initiative in the recipient economy. They crowd out local ideas, and cripple the evolution of the local way of doing things—not always deliberately, but just as effectively as if it were planned. Frequently, the donor-designed, donor-supplied, donor-managed projects displace local versions of whatever it is they are providing. Sometimes this is justifiable where, for example, traditional cropping methods are exhausting land that must now support greatly increased, and no longer shifting, populations. Even in these cases, the 'assisted evolution' approach that builds on technology already understood and culturally ingrained, is likely to work better than the wholesale transplant of new technology. Too often, the thoughtless down-grading of 'softer', more traditional technology, leads ultimately to higher social and economic costs, both in lost domestic production and in future foreign currency outflows.

Relatively abundant flows of aid tend to distract attention and priority from the other main source of foreign financing—more stringently and more efficiently applied—namely non-government guaranteed private commercial investment. Though globally less than half the size of official aid flows and effectively concentrated in a handful of the most advanced developing countries, private equity capital invested in commercially and socially sound enterprises, is the most developmental form of foreign savings. Equity investors are profit-driven and create incomes, savings and tax revenues. The servicing of foreign equity is automatically adjusted, through the profitability of the firm, to the basic viability of the projects financed and to the prevailing economic conditions, and only takes place after the government has received appropriate taxes (the level of taxes must be high enough to appropriate a large part of 'resource rents' but not so high that they are a barrier to foreign investment—this condition is a requirement of the first two of the Basic Criteria). Interest and capital on loans, particularly government guaranteed loans—official and private—by contrast have to be paid however unsuccessful the project, however hard-up the borrower may be.

The challenge

Perhaps the most worrying effect of the heavy use of foreign aid is that it creates an addiction. It builds up dependence, and the pain of withdrawal becomes too horrible to contemplate. By enabling an economy to become accustomed to certain levels of wage employment, and hence levels of import consumption, in jobs that depend on aid flows; by providing foreign exchange in excess of the amounts that can be earned by domestic production; and by substituting the relatively easily negotiated transfer of foreign savings for the much harder won savings that represent foregone domestic consumption, foreign aid creates the continuing need for non-earned foreign exchange, which is then filled by more foreign aid. Availability of foreign aid enables the economy to accustom itself to a level of imports that could not be sustained by domestic savings and non-aid sources of foreign exchange. If aid fills the gap painlessly, why should others strain themselves to achieve the same end?

On the face of it, these effects of aid are undesirable in terms of the explicit aims of aid programs as developed in economic theory and enunciated by donors and recipients alike. The rhetoric speaks clearly of aid diminishing over time, of recipients developing greater capacity to provide their own savings and foreign currency needs, and of building up a stock of the skills required by their expanding economies.

If donors and recipients are serious that aid is a transitional phenomenon, a stepping-stone for economies to reach a level of output that can become self-sustaining, they could readily put this to the test by rigorously applying the Three Basic Criteria to their projects and programs. Run them up the flagpole and salute them. Nail them over the doorway of the Treasury and the National Planning Office. These criteria provide the key to all those desirable goals espoused by aid on humanitarian, environmental and economic grounds—but with greatly reduced risk of diversion and addiction.

If the Three Basic Criteria were adopted and rigorously applied:

- aid would be fully and readily available for purchase of goods and services inside the recipient economy;

- much more use would be made of aid explicitly linked to direct private investment, providing essential infrastructure (external economies for the investor), to purchasing part ownership inventories for the recipient community, funding essential research and development costs;
- increased use would be made of NGOs with appropriate expertise in specific areas. Donor governments would fund international NGOs on an increased scale, and recipient governments would both draw on this assistance directly and encourage their domestic NGOs to do so; and
- aid would be much less tied to projects. It would be much more explicitly conditional on certain policies being followed by the recipient government, including:
  - stringent application of the Three Basic Criteria;
  - fiscal and monetary policies that effectively promote the growth of domestic savings;
  - taxation policies that promote private investment in traded goods production;
  - exchange rates that reflect the underlying, without-aid, scarcity of foreign exchange.

In this way, there is some chance that the explicit aims of aid programs might be fulfilled. Domestic savings would grow. Governments would refrain from dis-saving what the private sector has saved. Traded output would grow, increasing net foreign exchange earnings. Realistic pricing of all commodities, including foreign exchange would occur. Reforms, amounting in most aid-dependent economies to major structural changes, would open up the prospect of a diminishing dependence on aid, with real incomes rising and greater attention to income distribution and conservation of the environment also becoming feasible.

The real question remains—do those concerned really want to diminish dependence on aid? If they do, the application of the Three Basic Criteria advocated in this paper will help them. Or is the rhetoric simply a cover-up for a comfortable, mutually convenient set of relationships among those who operate the aid machine?