

FEATURES

The Cost of Foreign Aid to Developing Countries

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Nihal Kappagoda who is at present Vice-President, International, of the International Development Research Centre (IDRC) in Canada, examines here the "cost of foreign aid" in both economic and political terms and focuses on the problems that recipient developing countries face in absorbing foreign assistance. He was the Director of External Resources at the Ministry of Planning and Employment in Sri Lanka from 1970 to 1973, and draws profitably on his personal experiences. Many of these experiences are shared, in various forms, by other developing countries. His background of direct involvement in managing a developing country's external resources gives this paper special relevance in the debate on the 'debt issue'. This paper is based on a talk delivered to the Society for International Development (Ottawa Chapter) on December 13, 1977. The views are essentially those of the author and not necessarily representative of the I.D.R.C.

The need for enhanced transfers of foreign exchange resources to finance the development efforts of Third World countries in the post-1973 period has brought into focus once again the problem that recipient nations face in absorbing foreign assistance. The international community responded positively to the acute balance of payments problems that arose in these countries in 1973 and after, but in concentrating on the volume requirements that increased five-to six-fold annually on a global basis some of the qualitative aspects of foreign aid did not receive the same attention. The costs to recipient nations of absorbing increasing amounts of foreign aid continue as

in the past, in spite of international efforts to reduce them. This paper discusses some of the major problems that have been encountered by recipients and the progress that has been achieved in the 1970s to alleviate these problems, mainly through the initiatives of the countries of the Development Assistance Committee (DAC) of the Organization for Economic Co-operation and Development (OECD).

THE REPAYMENT BURDEN

The debt service problem has been discussed at virtually every international gathering convened during the past decade to discuss economic problems of developing countries. It figured high on the

agenda at the 1976 meeting of UNCTAD IV IN Nairobi and at the Conference on International Economic Co-operation (CIEC, the North South dialogue) that was concluded in the summer of 1977. The high levels of resource transfers to developing countries that have taken place since 1973 brought into sharper focus the need for international action on the debt question, because much of the borrowing since that time has been on hard terms from non-official sources, thereby increasing the repayment burden of developing countries. As seen from Table 1, private capital flows constituted 57 per cent of the total net flow of resources from Development Assistance Committee (DAC) countries in 1976 compared to 49 per cent in 1972, and during this period, annual transfers from official sources increased by only 61 percent compared to 134 percent from private sources.

There is no danger to an economy from a high level of borrowing even on hard terms, provided these funds have been used to build up the capacity to repay such debts. Specifically, a country borrowing heavily will experience a debt problem if it has not adopted policies that have generated a high rate of growth of foreign exchange earnings through exports of goods and services or if it has not adopted import substitution programs that will achieve real savings in foreign exchange expenditures. If a country's economic policies are not geared to achieving these objectives and it

TABLE 1. Net flow of resources from DAC countries and multilateral institutions to developing countries (millions of U.S. \$)

	1964-66 Average	% of GNP	1970	% of GNP	1972	% of GNP	1973	% of GNP	1975	% of GNP	1976*	% of GNP
Official Development Assistance	5926	0.44	6811	0.34	8538	0.33	9351	0.30	13590	0.30	13740	0.33
Other official flows	233	0.22	1149	0.06	1546	0.06	2463	0.08	3020	0.08	3430	0.08
Private capital	3932	0.29	7751	0.38	9609	0.38	12481	0.41	23330	0.61	22440	0.55
Total	10092	0.75	15711	0.77	19693	0.76	24628	0.79	39940	1.05	39610	0.96

* Preliminary.

Sources: Tables 1, 2, 3, 4 of Statistical Annex, Development Co-operation, 1976 Review: OECD, and page 25, Annual Report, 1977: World Bank.

TABLE 2. Global structure of current account balances
(billions of U.S. \$)

	1967-72	1970	1971	1972	1973	1974	1975	1976
	Av.							
Industrial countries	10.2	10.1	13.4	9.4	11.1	-11.2	18.6	-1.4
Major oil exporters	0.7	0.3	2.1	1.7	6.2	67.4	34.7	41.0
Other nonoil-producing countries	-9.8	-8.6	-11.0	-8.9	-9.6	-43.8	-53.0	-41.0

Source: *Annual Reports, International Monetary Fund.*

faces a sharp decline in export earnings or an increase in import prices, then the debt problems could become very acute because of higher borrowings needed to maintain import levels, if the additional resources have not been obtained on concessionary terms.

The benefit of a loan to a recipient is often measured by the grant element of the loan, which is the difference between its face value and the present value of the amortization and interest payments discounted by an appropriate rate of interest. This should normally be the rate at which capital could be borrowed by developing countries in international capital markets. Except to the high income developing countries, this rate of interest is often an academic concept, as they have no access to these markets. As a working rule, therefore, the grant element is estimated by discounting the repayment stream by 10 percent. For example loans that are extended by the International Development Association (IDA), which are interest free and repayable in 50 years including the grace period of 10 years, have a grant element of 90 per cent compared to 100 per cent for outright grants.

Recognizing the need for international action on the debt problem of developing countries, the DAC adopted a recommendation on financial terms in 1972 for Official Development Assistance (ODA)*. To fulfill these conditions, each member country was expected to reach and maintain an average grant element for their ODA commit-

*ODA is defined as resource transfers to developing countries and multilateral institutions provided by official agencies with the main objective of promoting the economic development and welfare of developing countries; it is concessional in character and has a grant element of at least 25 percent.

ments of at least 84 per cent. However, countries whose ODA commitments as a percentage of Gross National Product were well below the DAC average would not be considered as having met the target for financial terms. Further, in recognition of the problems of the least developed countries, it was agreed that ODA to these countries should preferably be in the form of grants and that the average grant element of all commitments from a given donor should either be at least 86 percent for each least developed country over a 3 year period or at least 90 percent annually for the least developed countries as a group.

Problem Worsens for Developing Countries

Since the adoption of this resolution on financial terms in 1972, considerable progress has been made in softening the terms of ODA. In 1975, the overall grant element of all ODA was 88 percent, much above the target of 84 percent. There is no question that positive steps have been taken by individual countries to meet this target, but the overall debt problems of developing countries have worsened by the greater increase in export credits and bank lending since 1972. The increasing financial requirements of non oil producing countries, which were brought about by higher oil prices, shortfalls in food production, and higher import prices in gene-

ral, are illustrated in Table 2, which presented the global structure of current account balances.

In contrast to the softening terms of ODA, the terms of the total flow of resources have hardened in the 1970s due to the declining share of ODA and the growth of Euro-currency lending of surpluses generated by oil-exporting countries, the terms of which have hardened. If one examines the non oil-producing countries, it is seen (Table 3) that the total debt outstanding increased by nearly two-thirds from 1973 to 1976 and this was accompanied by an increase in the proportion of commercial debt in total debt outstanding from 48 percent to 56 percent and in debt service payments from 67 percent to 77 percent.

If we next examine the debt outstanding in terms of the income groups (Table 4), it is seen that three-fourths of the debt up to the end of 1974 had been incurred by countries whose per capita incomes exceeded US \$ 200. The shift in the debt structure toward commercial debt on harder terms is common to all income categories but was most pronounced for those countries whose per capita incomes exceeded \$ 375. Debt on commercial terms now represents the bulk of their total debt, which is an indication of their credit worthiness, as well as their ability to raise funds in international money markets. Even in poorer countries with per capita incomes of less than \$ 200, commercial and other debts on harder terms accounted for 45 percent of total debt outstanding and for two-thirds of their total debt service payments, but this group of countries accounted for only 13 percent of total debt service payments in 1974. In 1975, debt service payments to DAC countries on ODA loans were only 19 percent of the total by all developing countries. These statistics show that the prob-

TABLE 3. Reported debt and debt services of non oil-producing countries
(billions of U.S. \$)*

	1973	1974	1975	1976
Total outstanding	79.0	96.8	116.3	129.0
Commercial debt (%)	48	52	54	56
Debt Service	9.1	11.8	15.0	17.8
Commercial debt (%)	67	72	75	77

* Excludes nonguaranteed private bank lending.

Source: *Table 11-4, Development Co-operation, 1976 Review: OECD*

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TABLE 4. Debt outstanding at end of 1974 and debt service (millions of U.S. \$) by income group

	Debt		Debt Service	
	(millions of U.S. \$)	(%)	(millions of U.S. \$)	(%)
Least developed countries	4967	(4)	339	(2)
Under \$200*	23653	(20)	1604	(10)
\$200-374†	8114	(7)	1012	(7)
\$375-699	17333	(15)	2049	(13)
\$700-999	17611	(15)	2379	(16)
\$1000 and over	30137	(26)	4709	(30)
Total nonoil-producing developing countries	96848	(82)	11752	(76)
Oil producers	20517	(18)	3733	(24)
Total	117365	(100)	15485	(100)

*Excludes Indonesia,

†Excludes Nigeria

Source: Table 34 of *Statistical Annex, Development, 1976 Review: OECD.*

lem is not with official flows but with private lending on commercial terms that has responded more to the increasing needs of developing countries than official transfers.

Several countries have experienced acute external positions brought about by excessive debt service payments, and debt relief of one form or another has been extended to some 50 countries since 1970. Included in these debt-relief operations have been multilateral arrangements within the framework of the Paris Club for Chile and Zaire and within the framework of the World Bank consortia for India and Pakistan. The writing off of debts has been on the agenda of various international conferences including the UNCTAD IV and CIEC but to date (Dec. 13, 1977) unilateral action has been taken only by Canada, which wrote off \$ 254 million of foreign debt with a present value of \$ 35 million owed to her by the poorest developing countries to whom she provides assistance, and by Sweden, which agreed to write off debts totalling \$ 236 million. Unfortunately, Canada did not follow through and failed to provide new aid to these countries on grant terms. International action on debt relief has been under consideration for some time, but the inability to obtain the support of the Eastern European Bloc for such action, among other reasons, has made it impossible to arrive at a general agreement covering groups of developing countries. Nevertheless, the serious debt service situations of many developing countries make it imperative for the international dialogue to continue.

THE TYING OF AID

The practice of tying foreign aid to donor sources began at the end of the 1950s in response to the balance of payment difficulties donor countries were experiencing at the time. This was the case with the United States when she began in 1959 to tie supplies financed by development loans to U.S. sources, and she even went further and ensured that funds remitted to meet local costs of projects were subsequently used for imports from the U.S. In the same way, the United Kingdom began to tie her assistance to U.K. supplies in 1963. This action on the part of donor countries that had balance of payment deficits also led to similar actions by surplus countries, such as the Federal Republic of Germany, due to pressures exerted by export lobbies who found their markets threatened by the actions of deficit countries.

One reason for tying assistance to commodities produced in donor countries is the existence of surplus stocks or excess capacity in industries. This was undoubtedly the motivating factor behind the origins of the PL 480 food aid program in the United States and was effectively an attempt to minimize the real cost of aid to the donor. To the recipient, however, the costs are high because of support prices maintained internally in donor countries for agricultural produce. A realistic method of valuing such assistance would be to price the quantities at a notional "world market price" had these supplies been released to the market.

In spite of these higher costs, it has to be conceded that the

existence of surplus stocks or excess capacities often results in additional resources being channeled to developing countries. Strong export lobbies in developed countries influence governments to extend credits to support sagging industries that have excess capacities or to dispose of surplus stocks that have arisen due to wrong market expectations and in such cases, aid is necessarily tied. Further, credits are given for the explicit purpose of export promotion of developed country products. In all these cases, the reasons adduced against tying would apply, but had it not been for export promotion or other policy objectives of developed countries, these additional resources would not be available.

Another reason for tying aid is the preponderance of project aid in total aid extended by developed countries. This is due to the mistaken belief that project aid is used more efficiently by recipient countries. But concentration on this type of assistance often results in the implementation of projects that are not often of high priority and leads to an incorrect allocation of resources for investment. There is also the cosmetic effect that a project is better identified with the donor than commodities whose use is more dispersed throughout the economy and not easily identifiable. Once a decision is taken to provide project aid there is even a greater reluctance to untie aid, because a project is better identified with the supplier of equipment and services than with the donor providing funds.

It bears repeating to mention what is often stated about the efficient use of external resources. It is the soundness of an annual import program within the context of a country's development plan that is important and not the financing of individual items or projects in such a program. Commodity aid provides greater flexibility in the use of aid and often leads to minimizing the costs resulting from the tying of aid to donor sources.

Basically, the direct costs of tying arise from paying FOB prices that are higher than world market prices. There could be two reasons for this. First, suppliers in donor countries, realizing that the goods are financed under aid programs and that the recipient country has no choice but to make

this purchase under aid, charge a monopoly price. This would be minimized to the extent that it is possible to invite worldwide tenders and then select a supplier from the donor country and to the extent that there are a number of suppliers to introduce an element of monopoly pricing but the situation is worse when there is only a monopoly supplier in the donor country. Second, the cost of production in the donor country may be higher than from the traditional source, which is the main reason why purchases were not made from the donor country originally. This arises often in cases where imports are diverted from traditional sources. The tying of shipping and insurance to donor sources also adds to these costs.

The Additional Costs Can Vary

The additional costs, of course, vary from country to country and depend on the multiplicity of donors, the volume of assistance from traditional sources of supply, the possibilities of competitive bidding, and the goods that could be purchased using aid funds. There are in addition indirect costs that cannot be easily quantified. These result from the use of aid for low priority items due to the dictates of donor countries, the distortions in the price structure (which is, in any event, complicated in a developing country), and the administration costs of managing a tied-aid program where disbursements have to be controlled to ensure the correct source-wise procurement procedures laid down by donor countries. Accordingly, the real value of foreign assistance is reduced, and the disbursement procedures required to ensure source-wise tying result in waste and delays in the transfer of resources and also dampen the expansion of trade, especially between developing countries.

Theoretically one could minimize the cost of tying aid by inviting international bids for commodities and projects and selecting the cheapest source, provided that adequate assistance is available on time to finance the imports. An accurate estimate of the cost of tying could only be obtained by international bidding conducted on a freely competitive basis, which condition is unlikely to be fulfilled in practice, and it is probable that these costs are not less than 20 percent. The knowledge of the availability of

tied funds could result in monopolistic pricing by suppliers from donor sources and indifferent bids from other suppliers. Another factor that has to be borne in mind in project financing is that the recipient often lacks the technical expertise to negotiate cost reductions.

International discussions, mainly by the DAC, on untying aid began in the mid 1960s. By the early 1970s agreement had been reached only on untying contributions to multilateral institutions by DAC countries, which did not effectively change earlier practice though it represented a moral commitment by the group as a whole and in 1975 these funds constituted 28 percent of total ODA. Progress towards untying bilateral loans has been limited and to date 10 DAC countries have collectively signed the agreement on untying bilateral development loans permitting procurement in developing countries. Following the impetus given by UNCTAD IV and CIEC fresh initiatives have been taken toward untying but the progress made in quantitative terms is unknown at the present time.

Apart from joint action by DAC, some countries have taken individual initiatives toward untying aid. By 1970, the United States authorized procurement in almost all developing countries and increased the permissible foreign content of aid-financed goods. The Federal Republic of Germany also removed many restrictions on capital project aid and technical assistance equipment around this time and Canada too decided that up to 20 percent of bilateral aid could be used for purchases in developing countries or to meet local costs. In 1975, the U.K. decided to permit procurement in countries whose per capita incomes were less than \$ 200, whilst Japan also took legal measures that were necessary to facilitate untying aid.

The position regarding the financing of local costs has been more liberal. Donors such as Sweden and Norway permit all their bilateral project aid to be spent on local costs. Others permitted it for the poorer countries when directed to agriculture and social development projects. In some cases, local costs are financed for particular recipients as in the case of France for the francophone countries.

These have been the recent changes in the developed countries of the West. Amongst the centrally planned economies, only China has permitted the financing of local costs or provided united assistance in the form of cash grants to some developing countries. The costs of tying aid are even greater in the case of these countries as we deal with a monopoly supplier in the donor country, whose prices are fixed by considerations not apparent to those outside and price reductions are almost impossible to achieve.

DISBURSEMENT PROCEDURES

The timing of agreements and disbursement procedures are often key elements in the effectiveness of aid programs to a recipient country and delays in these processes add to the cost of aid to the recipient. In the initial phase of a country's development, particularly those that were colonized by the metropolitan countries, foreign aid was obtained mainly from one country. As these countries developed, both politically and economically, and took their place in the international community, the reliance on a single donor decreased in importance and recipient countries began to deal with a multiplicity of donors whose procedures and practices differed considerably. This process was evident even in the 1970s when the number of developing countries obtaining more than 50 percent their total bilateral and multilateral assistance from a single country decreased from 43 in 1970 to 30 in 1974.

As a result of the multiplication of donors interested in assisting a single recipient, action was taken in the late 1950s to set up coordinating mechanisms of one type or another by multilateral institutions such as the World Bank, beginning with the consortia set up by the World Bank for India and Pakistan in 1958 and 1960 respectively. The Bank also set up other coordinating mechanisms such as consultative groups and aid groups for discussing foreign aid requirements of recipient countries individually, and this certainly helped countries facing acute balance of payments problems as it enabled the total foreign exchange requirements of a recipient to be looked at by the donors as a group on an annual basis. But this still left the negotiation of agreements by each donor to an

independent process determined by the internal approval procedures of donor countries for approving aid allocations to individual countries.

A development that improved the timing of agreements was the introduction of country programming by many DAC countries such as Canada, Denmark, Finland, France, Germany, New Zealand, Norway, Sweden, Switzerland, and the United Kingdom. In spite of this, the availability of funds was yet dependent on budgetary appropriations approved by the legislatures in the donor countries and only limited action has been taken to provide developing countries with the multiyear commitments.

For example, the Australian authorities permit commitments 1 year ahead of 75 percent of current aid levels, 50 percent 2 years ahead, 25 percent 3 years ahead, and 10 percent 4 years ahead. In the case of Canada, I understand that allocations for the main recipients, which number around 35, carry forward commitment authority of 75 percent for each of the 4 succeeding years.

It is true that the coordinating mechanisms and the country-programming exercises of donor countries have improved the timing of agreements, but the improvement has only been marginal. Aid decisions are yet made independent of the overall coordinating mechanism and the uncertainty regarding the timing of agreements increases the difficulties of managing a country's foreign exchange budget. The delays in this process should not be underestimated, and this led the Pearson Commission to report (in 1969) that in the case of United States Development Loans, the checklist of statutory provisions required at that time before a loan can be approved had reached 68 separate items. Ideally, developing countries, require information in advance of the total quantum of aid that would become available annually and the commodities and projects for which these funds could be used. It is for this reason that the Pearson Commission recommended that the aid appropriation period of donors should be extended to at least 3 years and that appropriated funds could be carried forward for several years. Agreement could be reached in advance of the quantum of aid and the items to be purchased and the signing of agreements

should not affect the utilization of aid provided the disbursement procedures of donor countries permit reimbursement of expenditure incurred prior to the signing of agreements. This is often not the case and in the case of many developing countries, it would not be a feasible alternative as they do not have adequate foreign exchange resources or access to short-term lines of credit to permit advance purchases.

Cause for Delays

Apart from the timing of agreements, the disbursement procedures of donor countries also result in considerable delays. Where a country has a multiplicity of donors, the detailed disbursement procedures of each country have to be mastered by the coordinating agency in the recipient country, as well as by the licencing authority and the importers receiving allocations under each program. The realization of this problem led the Pearson Commission to comment: "Hard pressed and frustrated administrators on both sides may some times be pardoned for wondering whether their programs will fail because they will run out of carbon paper".

The negotiations on the list of items that could be permitted under each program often result in protracted bargaining between the donor and recipient: the latter is more interested in financing items that would have a greater impact on the country's development and permit quicker disbursements, whereas the former often has to balance export promotion interests in the donor country with the development needs of the recipient country. This varies from donor to donor and it depends on the influence that export lobbies exert on these governments. The next delay is the approval of individual contracts. Often tenders have to be called in the donor country and after a decision is taken on each one, the prior approval of the aid agency in the developing country is required and payment for each contract is made direct to the supplier. Some donor countries have permitted the reimbursement of expenditure, upon submission of documents for goods that have been shipped and payments made, for items agreed upon between donor and recipient. Even after following these elaborate procedures and gaining approval for a

purchase, the US-AID audit could call upon the recipient country to refund the amount disbursed for an item purchased using a U.S. Development Loan if any irregularity is later discovered.

Not all the blame is on the donor country. The recipient countries also have elaborate licencing arrangements that have to be dovetailed with the procedural requirements of the donor agencies. Often, in the interests of equity, aid allocations are distributed amongst numerous importers making it necessary for each of them to master the procedures of each donor agency. It also reduces the real value of aid eliminating the possibility of obtaining discounts on bulk purchases and reductions in shipping costs that could be achieved by bulking. It is perhaps difficult to imagine the delicate balancing act performed by many administrators in developing countries who are called upon to administer these aid programs. Often imports of critical commodities are financed on aid and delays in their arrival have a chain effect on the economy that cannot be avoided in the short run. For example, delays in fertilizer imports financed by aid effects the entire food production effort of the recipient country and it is often not possible to overcome this problem by purchasing commodities from abroad at short notice, either because it is physically impossible to affect shipments within a short time period or the foreign exchange resources needed to finance such purchases are not available at the time.

POLITICAL AND ECONOMIC COMMITMENTS

The influence by donor countries on the domestic policies of recipients has been dealt with extensively in many publications but more critically and not altogether impartially in books such as Teresa Hayter's "Aid as Imperialism" and Cheryl Payer's "The Debt Trap: The IMF and the Third World." I think it is necessary to look at specific examples to understand the full implications of the so-called leverage effects exerted by donors and for this purpose I will quote some examples from Sri Lanka.

In the preceding sections, I dealt briefly with the role coordinating mechanisms have played in expediting the flow of resources to developing countries. It is how-

ever, normal for donors belonging to consortia, consultative groups, or aid groups to base their decisions on foreign aid to developing countries on the framework of economic policies adopted by the country concerned, as analyzed and presented by the agency sponsoring the co-ordinating group. It is normal for growth-oriented economic programs to receive the endorsement of donor countries by pledges of higher volumes of assistance. However, in these analyses, the World Bank and the International Monetary Fund, which have been responsible for sponsoring most of the co-ordinating groups, emphasize the impact of domestic policies on private enterprise, the operation of market mechanisms, the promotion of private investment both domestic and foreign, all of which are important for the creation of a capitalist society. It is relevant to question whether much of this is applicable to a society that is backward and based for the most part on a subsistence economy. Even the World Bank has now modified its position on the pursuit of growth-oriented development and has over the last few years turned its attention to basic human needs such as nutrition, health care, education and housing by its support for integrated rural development projects. But nevertheless, the orientation and thinking of these institutions are based on the operations of the market place. For example, subsidies are often an integral part of government programs for the distribution of the basic necessities to the masses in developing countries and this is anathema to these institutions and no opportunity is lost to pressure developing countries to eliminate them in the interests of increasing investment for growth. A recent example was the attempt by the Government of the Arab Republic of Egypt to remove subsidies on a series of basic necessities as part of a Standby Agreement with the International Monetary Fund signed in 1977, and it led to widescale disturbance in Cairo and finally of the withdrawal of the measures.

No one could really quarrel with the prescription made to divert more resources for investment in the interest of achieving higher growth rates, but it has to be understood that such policies often

have to be implemented within the framework of democratic political institutions. The pressures such systems exert on the political leaders in developing countries can never be understood by Western societies and it is largely brought about by the access that people have to the political leadership in these countries. In such a situation the elimination of subsidies and other welfare-oriented policies have to be gradual and implemented with the full support of the masses. Otherwise these pressures can only be controlled by changing the political systems to autocratic ones, employing repressive tactics. This again is unacceptable to the Western societies, which emphasize, as U.S. President Carter's human rights program does, human liberties and this is an area of conflict based on different conceptions of political institutions and the process of development.

Specific Policies Insisted Upon

The need for sound economic policies as a general precondition for providing foreign assistance cannot be questioned as it is in the interest of the recipient country to use the additional resources generated through foreign aid programs as effectively as possible. But nevertheless, one questions the need for specific economic policies that are insisted upon by donor countries before providing aid. Here I would draw a distinction between commodity assistance and project assistance. In the former, sound overall economic policies are more justifiable preconditions than in the latter where the feasibility of the project and its priority in the country's development plan should be the main concern. The need for project assistance should be judged on the merits of the proposal rather than the overall framework of economic policies or the political institutions under which these policies are being implemented.

An additional cost to a recipient in the case of project aid is the need to hire foreign consulting firms to execute projects, the cost of which are debited to the loans, to satisfy the donor countries regarding their implementation. This often leads to the justifiable accusation of neocolonialism against the donor as many developing countries possess qualified technical personnel to supervise

the implementation of projects, though they may lack the experience of working as a team within the framework of a consultancy organization. In a similar way the practice of the World Bank and the Fund in placing staff in developing countries to monitor the implementation of programs is questionable.

One important aspect of the leverage effects is that often the preconditions imposed impinge on the sovereignty of developing countries. Here, I would like to use an example from Sri Lanka where in early 1970 the World Bank provided assistance for a major diversion project and insisted on including two clauses that were objectionable; first, that that Government appoint as the Chief Executive and the Deputy of the statutory body responsible for the project, persons who were both competent and experienced and acceptable to the Bank; and second, that prior approval of the Bank be obtained before changing any legislation governing the statutory body. This agreement created serious political problems in the country and became a major issue in the general election that year. The Government that negotiated the loan agreement was defeated and the new Government renegotiated these clauses, which were subsequently deleted and substituted by clauses whereby the Government undertook to merely inform the Bank of changes in the management and legislation.

One would have expected these experiences to have settled the issue for all time as far as Sri Lanka was concerned but it came up once again two years later with the Asian Development Bank. The ADB is, after all, a regional institution and is expected to be more sympathetic towards the aspirations of Third World countries. Nevertheless, they insisted on consultation when changes in top management of another statutory body was contemplated as a precondition for providing assistance. Explanations to the negotiating team of the experience with the World Bank on the diversion project proved to be of no avail and the Government broke off negotiations, which was the first occasion in the history of the Bank, up to the time, that a recipient country had taken such action. Subsequently, negotiations were resumed and the offending clause deleted by the substitution of a Side Letter whereby the Government undertook to inform the Asian Development Bank of any proposed changes in the top management.

These are particular instances but they nevertheless point to the need for recipient countries to be constantly aware of the danger of acceding to such conditions as they constrain the recipient to a course of action that is both unpalatable internally as well as being a commitment made for a long period of time.

SACRIFICE OF LONG-TERM DEVELOPMENT OBJECTIVES

The rationale for negotiating foreign aid is to increase the import capacity to a level necessary to achieve a given rate of growth as laid down in the country's development plan. At the same time, it often enables the recipient to avoid taking harsh economic decisions that would be politically unpalatable in the short run. One could provide examples of cases where actions to curtail imports of agricultural products could develop the capacity to grow these items locally. In the short run, the internal prices rise and provide the necessary incentives to increase production locally but at the same time the increase in prices leads to demands for high wages, which, if granted, could set off an inflationary spiral. However, the availability of foreign aid in the form of agricultural products that can be grown locally or cash grants that would enable the importation of these items sacrifices the long-term development interests of the country because of the predisposition of many governments to reduce internal prices for short-term political gains. One could point to similar examples in the other sectors but the adverse effect is most often felt in the agricultural sector.

Food aid, whether provided under emergency conditions such as famines and natural disasters or provided for balance of payments reasons, has an impact on domestic production in recipient countries. Emergency food aid is a necessary response of the international community to meet national disasters such as famine, earthquakes, etc. Nevertheless, there are examples of cases where due to a lack of coordination amongst donors or an inadequate assessment of needs to overcome such disasters, the farming communities in the disaster areas have been adversely affected. The uncoordinated efforts in the Sahel and in Bangladesh are now historical facts. A recent example

quoted in the New York Times of 6 November 1977 relates the experience of Guatemala, which received emergency food supplies from the United States after the earthquake in 1976. At the time of the disaster, most agencies operating in the country recognized that adequate supplies of food were available but building materials were in short supply. In spite of this assessment, food aid arrived and damaged the financial prospects of the small individual farmers living in the highlands of Guatemala City who found the prices for their produce had declined sharply due to the availability of aid supplies. It had the further adverse effect of weakening the financial structure of farmer cooperatives in these highlands regions and is a good example of aid sent with the best of intentions, but misplaced and damaging to the recipient because advice from the local level was not accepted.

If one looks at the food aid provided as balance of payments support a similar situation emerges. It represents surplus stock purchased from aid allocations at high prices due to the support provided by donor governments internally to agricultural products. The consumer in the donor country often pays more because of aid purchases, which are added to the demand of consumers in donor countries. These food supplies are then sold in the recipient country reducing the prices of local supplies and substitutes, thereby damaging the long-term interests of farming communities in recipient countries whilst benefiting the urban consumers. If one looks at the entire picture from the source of production in the donor country to the consumer in the recipient country, it is the farmer in the donor country and the urban consumer in the recipient country who benefit at the expense of the consumer in the donor country and the farmer in the recipient country. Clearly, this does not promote development in the Third World, although food aid provided in this manner affords immediate balance of payment relief to recipient countries. It is not in their long-term interests to rely on food aid on a continuing basis, year after year.

Here again, I would like to quote an example from Sri Lanka whose staple food is rice. There have been

numerous attempts made to grow other food crops such as sorghum, maize, millet, cassava, and yams, but in the past, these efforts have been launched during periods of drought as an emergency measure to switch consumption from rice to other cereals that require less water for production. Such a situation arose in the financial year 1974-75 and due to the lack of rain during the period preceding the main cultivation season it was abundantly clear that there would be a substantial shortfall in the local production of rice. Faced with this situation, the Government launched a major production program to encourage farmers to grow other food crops and due to balance of payments difficulties during this period, the distribution of imported wheat flour was also restricted. Around March 1975, the US offered 100,000 tons of wheat flour, which they asked the Government of Sri Lanka to ship before the end of the fiscal year on 30 June 1975. In anticipation of these additional supplies, the Government of Sri Lanka liberalized the distribution of flour from the month of April 1975 onward, as this coincided with a festival period in the country. This was unfortunately the harvest period for the other food crops that had been grown and the farmers suffered catastrophic losses in income. A major extension effort by the Agriculture Department received a setback as the farmers required considerable persuasion to grow these other crops and the country's long-term development prospects were seriously damaged.

Conclusion

In dealing with this subject under five headings, I have not assigned any priorities to them. The repayment burden is the one that persons interested in international development are familiar with and it is readily quantifiable. Nevertheless, the others are real costs that reduce the value of foreign aid to the recipient. Perhaps I have introduced a note of pessimism to the foreign aid effort, but my main purpose is to draw attention to the need to improve the qualitative aspects of aid, at a time when the volume of resource transfers is increasing sharply. Both aspects are important and should continue to receive the attention of the international community in the interests of Third World development.