Aid and Development Policy in the 1990s

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I have written a paper on aid and development policies on the assumption that an international monetary system must have, as an integral element, policies regarding development and resource transfers stemming from aid flows.

There has been an upheaval in economic thinking and policymaking in most developing countries in the last few years. Nearly two thirds of them have recently adopted adjustment programmes, supported by the IMF, World Bank and other international agencies. They are trying to get integrated into the mainstream of the world economy by adopting more liberal, market-oriented policies. But the history of such efforts is full of examples of failure: sometimes, unforeseen shocks have pushed reform programmes off track, often exports did not increase as projected, nor did aid materialise as promised. The developing countries therefore have argued that, when they adopt radical adjustment programmes in consultation with the international financial institutions, the industrial countries should supply the required help in cash, credit and market access.

Aid and development policy should take into account the revolutionary changes in the world economic and political system which have followed the collapse of the Soviet Union and the end of the Cold War. Its approach should be reoriented to supporting the structural transformations taking place in developing countries. There is now a widespead recognition that market forces should be allowed to operate freely both within and across national boundaries. Governments have realised that the regulation of prices, investment, trade and exchange or restrictions on the movements of goods and services, and of factors of production, usually result in a substantial loss in welfare. There is also a rethinking about the role of the state in economic activities, about central planning, policy coordination and the state's ability to influence the evolution of the economy.

As a result of this almost universal shift of policy towards liberalisation, most economies are becoming increasingly globalised. They are being integrated with each other, not only through the interdependence of trade

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and financial transactions, but also through expanding interlinkages of production and investment as well as marketing and technological tie-ups. For the developing countries, opening up to global competition and becoming integrated into the mainstream of the international economy, rather than operating on the periphery, would place them firmly on a sustained path towards growth and development. The pre-condition for that however, would be that they adjust their economies rapidly to the requirements of globalisation. In the new world of the 1990s, the main objective of aid and development policies should be that of helping developing countries to integrate into the global mainstream. This would imply assisting them in implementing programmes of domestic economic reform, and creating the trade and investment environment for them so that their development efforts can be sustained through increased resource flows and foreign exchange earnings. At the same time, the aid and development policies will have to continue to serve their traditional objective of supporting the long-term development goals of building infrastructure and financing social projects.

I. THE OBJECTIVES OF AID AND DEVELOPMENT POLICY

The objectives of aid and development policies of OECD countries have been quite diverse, depending upon their historical and contemporary commercial and political ties with specific developing countries. They have also been guided by their perception about evolving international relations. In general, however, until recently, their objectives could be summarised under three broad headings: (1) military and political considerations; (2) concerns about social justice, poverty alleviation and human development; and, (3) mutuality of interests. Most of the OECD countries channelled their assistance bilaterally as well as multilaterally, in the form of either financial assistance and technical support or trade concessions and market access.

Military and political considerations

The military and political considerations were directly related to the bipolar division of the world, when the superpowers were trying to build up alliances across their borders with countries in the Third World. With the end of the Cold War, the motivation for military alliance may have disappeared, but the ramifications of power politics have not, and the promotion of spheres of influence with economic and commercial assistance remains an aim of development policy for many OECD countries. The special relationship that the European Community has with the Lomé countries is an example of

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nurturing a sphere of influence without any military alliance.

Recently there has also been a tendency towards forming regional economic blocs. This new development is motivated partly by the interests of trade and enlarged access to markets, but more so by the political considerations of alliance, ethnic affinity and prevention of a possible flow of unwanted immigrants.

As long as the political considerations of the old or new variety keep influencing aid and development policies, it may not be possible to achieve the best distribution of aid and the optimal application of development policy, serving the objectives of development and integration of the developing countries into the global economy.

Social justice and human development

Concern about social justice, poverty alleviation and human development have traditionally been the most important motivation of the aid and development policies of the industrial countries. The policies of assisting the poor, whether at home or abroad, have been inspired in the industrial democracies by a sense of altruism and charity and a respect for the values of justice and equity. While there is now growing pressure in industrial countries to cut expenses and to let the market forces decide among a number of alternative sources of the delivery of welfare, the principle that the richer sections of the population should take on the burden of meeting a substantial part of the basic requirements of the poor has been almost universally accepted.

The aid performance of most OECD countries has fallen far short of the target of 0.7 per cent of GNP as specified in the United Nations resolution. But this should be seen in the context of the steadily rising public expenditure in most of the OECD countries during the last two decades and the increase in competing claims on public funds from domestic sources. The shortfall in aid delivery should therefore not be explained in terms of a general apathy towards social justice and equity, but rather in terms of a failure to persuade the electorate about the effectiveness of foreign aid in promoting social justice abroad.

Mutuality of interest

The traditional arguments for mutual interest are basically related to (a) trade and supply of commodities (b) expanding markets for manufactures and (c) widening the scope of profitable investments. However, industrial countries generally chose to reduce their dependence on imports of commodities and raw materials from the developing countries and to expand their trading and

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investment activities within the industrialised part of the world. The paradigm of mutual interest thus remained an unrealised driving force behind aid and development policies.

In the altered context of the 1990s, when the developing countries are pursuing economic reforms and structural adjustment, the argument of mutuality of interest would seem to have gained a new lease of life. For, if the developing countries follow appropriate policies, and successfully adjust their economies to achieve a sustained rate of growth, a partnership with them could be highly beneficial to the industrial countries. Commodity supplies could be stabilised through increases in their productivity with the injection of both domestic and foreign investment. With a large population, expanding growth, increased capital formation and an improved functioning of the infrastructure in these countries, their potential as markets for exports and profitable outlets for investment from the industrial countries would expand enormously. As these countries develop and build up their industrial complementarities with the countries in the North, they could become extremely effective partners through joint ventures, sub-contracting and production linkages within the same industry. In other words, developing countries that have, until recently, been looked upon only as markets for the exports of the industrial countries, could now be the sources of imports into the industrial countries, thus providing a large scope to the profitable operation of multi-national enterprises.

Of late, environment has come up as another source of mutual interest between the industrial and the developing countries. The scope of the mutuality of interest in this area is so vast that a larger international programme of aid and transfer of resources can be built just upon the possibility of environmental cooperation.

II. THE DESIGN OF AID AND DEVELOPMENT POLICY

Given the objectives of aid and development policies in the altered world of the 1990s, their effective implementation would depend very much on their design, and the way they are actually applied in a specific country. The elements of that design would, of course, have to be flexible and varied, to accommodate differences in the objective conditions in the different countries, such as levels of development, and the nature of the social, legal and political infrastructure. The relationship between the beneficiary and the donor countries, its history and the perceptions about its future, would also influence the framing and the application of these development policies. Nevertheless it should be possible to design a basic structure for such policies, which different donor countries might follow to help beneficiary

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countries in implementing economic reforms, becoming integrated into the mainstream of the world economy and launching themselves on a sustainable path of development.

Conditionality and reciprocal commitments

The most important basis for such a design would have to be a credible commitment by the beneficiary countries to economic reform, involving some sort of conditionality. Although most of the bilateral assistance for development so far has not been linked to any explicit conditionality, it is high time that developing countries realise that without some conditionality they can no longer expect any significant flow of assistance. There are too many conflicting claims on the limited savings of the industrial countries, and there is very little leverage left for developing countries to extract development assistance without demonstrating their ability to use that assistance effectively with appropriate policies.

There already exists a vast literature on conditionality and also a long and varied experience of its implementation by the IMF, World Bank and regional development institutions. We do not need to go into these issues in any great detail, except to point out three aspects which are relevant for the formulation of the new development policies. First, conditionalities should be related to some form of monitoring of the fulfilment of commitments of the beneficiary countries, and not to the actual achievement of their objectives. Secondly, conditionalities cannot be used as a rationing device for development assistance, for harsher conditionalities do not mean greater effectiveness in the use of assistance. Thirdly, the commitment to carry out the adjustment programme will be improved if the developing country receives sufficient external finance.

Since a typical developing country is a combination of different sectors at different levels of development with different types of problems, and the aid and development policy has a number of objectives, it is almost impossible to identify ex ante, a set of policies that would be sufficient to ensure success. Most of the time, the policies would have to be flexibly applied, modified and improvised in the evolving situation of an economy. The best one can expect from the authorities is that they remain committed to following the right policies and maintain the strict fiscal and financial discipline that is necessary to avoid any waste of resources. Therefore, conditionalities for a particular country should be centred around a few indicators that would reflect the country's adherence to those disciplines, such as the reduction of fiscal deficits, or control of money supply, or financial and physical deregulation. The indicators must be sufficiently strict to demonstrate the commitment of the authorities, but at the same time they should be

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reasonably phased to be implementable without disrupting the political system.

The idea behind using conditionality mainly for monitoring the commitment of the policymaking authorities, and not necessarily for monitoring the implementation of an elaborate policy programme, is quite simple, though not always generally appreciated. It is often forgotten that the implementation of an adjustment programme is in the interest of the countries themselves. They would usually stick to it if it is perceived as appropriate. It may be necessary to change an adjustment programme, with the help of external agencies and experts after a full discussion. But it is not necessary to impose the compliance of the country to the programme by monitoring the details. If the commitment of the authorities can be monitored and ensured, compliance to the best implementation of the programme would also be ensured.

The prospects for compliance to the policy commitments of a developing country would improve enormously, if it is assured of all the assistance required for implementing reform programmes. This third aspect of conditionality mentioned above has a special relevance for aid and development policy of the 1990s. Conditionality, especially for the IMF programmes where it has been originally applied, involves a form of reciprocal commitment. If a country undertaking a financial programme fulfils its commitments, the Fund is supposed to automatically disburse the sum it has committed for payment. The Fund's commitments are based on an assessment of the amount of external finance that the country would require, after taking into account all other sources of finance, to implement the programme. With the passage of time and global shortage of transferable resources, especially in the 1980s, this aspect of reciprocal commitments, implied in the conditionality of the Fund programme has been increasingly diluted. The Fund's own resources have proved to be inadequate and, with growing arrears in its repayments, it has been forced by its major shareholders to drastically limit access to its resources. A commensurable amount of resources have not been forthcoming from other bilateral and private sources, in spite of the Fund's efforts to play a catalytic role. As a result, the Fund's programmes have either remained underfunded with unfulfilled financial assurances, or have had to be unduly tightened with a severe compression of expenditure, leading to a contraction of output, employment and living standards.

If the objective of the aid and development policy of the 1990s is going to be helping the developing countries to adjust their economies through structural reform and integration into the mainstream of the world economy, the industrial countries must restore this reciprocal element to the conditionality. If a developing country launches a programme of economic

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reform, it should be assured of all the financial, technical and structural assistance as well as market access and developmental support needed for a successful outcome of those reforms. If these assurances are not forthcoming, the developing country cannot be expected to carry out the reforms and structural adjustment and comply to the stringency of financial discipline except for a limited period. The hope that the success of the reforms would improve the country's credit rating and eventually increase the inflow of private funds is so tenuous and uncertain that unless the reforms produce positive results in a very short period, the contractionary effects of an adjustment programme may force the authorities not only to interrupt the reforms, but also to adopt policies of short-term relief that could be highly counterproductive in the long run.

Market access

Once a feasible programme of reform has been worked out and a set of minimum conditionality accepted by a developing country to demonstrate its commitment to implementation, the industrial countries could reciprocate along the lines of new aid and development policies in the following three ways. First, they could ensure free access for the reforming countries' exports to their markets and provide all possible financial, technological or promotional assistance to build up the export capability of the developing country. It is important to note that all programmes of structural adjustment and market reforms of a developing country imply a reallocation of resources, facilitating increase in export production. These programmes cannot be successful if, at the same time, a stable and expanding market for the exports of this country is not created. Furthermore, such markets should be stable with a reasonable certainty of access and potential for growth, so that these sectors can attract an increasing amount of investment from both domestic and foreign private sources. Given the size of the market of the industrial countries, such a policy would be beneficial even with a small growth of the GNP of those countries.

The ideal policy would be for the industrial countries to provide completely free access to the exports of reforming developing countries, without any restrictions or sectoral limitations. The welfare of the industrial countries can only increase as a result of granting such freedom of access, even if it is completely unilateral. Their imports will be cheaper, real incomes will be higher and resources released from industries losing out in the competition with the developing countries, can be absorbed in other, more efficient, industries, especially with their growing real income. The success of economic reform in the developing countries would create the potential of an expanding market for exports of the industrial countries in

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the immediate future, making the case for granting unilateral free trade access a strong one. The interests of labour and capital which would benefit from those newly-opened markets would not necessarily be the same as those displaced by competition from imports from the developing countries. If the authorities of the industrial countries can make the arrangements to accomodate the displaced labour and capital, there is no reason why free trade access should not be provided to some selected developing countries.

The existing GATT provisions have allowed some members, such as the European Community, to provide preferential treatment to its associates by giving free trade access in return for a promise of opening the markets of these associates, selectively, over time, and differentially, among sectors. Similar provisions can be invoked if industrial countries decide to extend the privileges of associateship to specific developing countries which have undertaken credible programmes of adjustment and reforms. This would not go against the spirit of the GATT.

Alternatively, the industrial countries may adopt the Generalised System of Preferences (GSP) route, by enlarging GSP to selected developing countries undergoing adjustment. To make this policy an effective means of supporting the reform efforts, without introducing market distortions, this enlargement of preferential access should be stable, certain and transparent. It should be free from quota restrictions, subject to simple and uniform domestic value addition requirement, and extended universally to all exports from these countries. It is important to emphasise this point because any attempt to restrict the GSP, either in terms of quotas or sectors of products, would distort the export markets of these developing countries and might give altogether the wrong signals to investors, thus frustrating the objectives of deregulation. Similarly, such GSP should be extended to Non-Tariff Barriers, which have turned out to be, in recent times, the most harmful barriers to trade. The Non-Tariff Barriers, because of the uncertainty of the time and the extent of their application, may often prove to be the single most important disincentive for investment in the export sector of developing countries. A GSP for Non-Tariff Barriers can go a long way to removing that disincentive for a reforming developing country.

The European Community is trying to integrate its own members through a policy of free trade and unrestricted movement in goods, services, capital and labour, with structural help to build up the competitiveness of its weaker sectors. It has extended this policy of integration to several countries outside the Community, by granting them associate membership. To the East European countries, it has offered gradual trade liberalisation, technical assistance, financial aid and technology transfer. Those countries, in return, would have to adopt economic reform policies, so that they could become effective partners. A logical, further step in the Community's development approach would be to confer similar privileges to the reforming developing countries. In this way, the Community could become the most helpful partner in their process of adjustment and integration into the world economy.

Balance of payments finance

The second element of the reciprocal commitment in the new aid and development policy I propose, is related to providing adequate balance-of-payments finance to meet the resource gap of a developing country undergoing an adjustment programme. These resource gaps are estimated as a difference between the import and other foreign exchange payment requirements and export and other foreign exchange earnings of the country during the adjustment period, over and above the regular inflow on capital account. Since import requirements are projected on the basis of growth of output and consumption, as well as the time required for completing the process of adjustment, the quantum of the resource gap becomes dependent upon the targets and the design of the programme. If there is an assurance from donor countries and international financial institutions of adequate financing, the programme can be so designed that the consumption standards are not unduly depressed, and that the growth of output and employment is maintained at a satisfactory level, without unleashing inflationary pressures. The prospects of its successful implementation improve not only by facilitating smoother adjustment of economic activities but also by increasing the political acceptability of the consequences.

There is another aspect of such an assurance of adequacy of financing which is related to the occurrence of unforeseen contingencies. Quite often changes in exogenous factors, not taken into account at the time of the formulation of the programme, produce such an adverse impact on the economy of the adjusting countries as to disrupt the process of implementation until new arrangements are put in place. If the industrial countries fulfil their assurance of adequate financing and adjust the quantum of assistance to meet contingencies, reform programmes can remain on track.

Social expenditure finance

The third element of the new policy would be related to maintaining the flow of external assistance required for carrying out the minimum expenditure on social and development infrastructure, and providing additional safety-nets for ameliorating the conditions of social groups adversely affected by the programmes. It is important for the success of any adjustment programme, whether for a sustainable stabilisation or for structural reforms, that social and economic infrastructure facilities are maintained at a reasonable level. For most programme countries with an inadequate supply of external resources, these are the areas where the expenditures are usually cut substantially and often in an ad hoc manner. These involve anti-poverty programmes, retraining, maintenance of essential food supplies, etcetera. An assurance from the donor countries to provide resources to maintain these expenditures would help in avoiding such cut backs. Short run adjustment measures have the maximum chance of success if they complement the long term measures for development on economic, social and human infrastructure.

Development Compacts

If there is general agreement among industrial countries about the elements of the new aid and development policies in the 1990s, as described above, there would still remain a problem of institutionalisation of their application. First, there would be the problem of how to design and set up conditionality in an objective manner, guided by the requirements of the circumstances and not by the political interests or the bargaining strength of the donor and the recipient countries. The simplest solution to this, without creating any additional institutional mechanism, would be if these were left to international financial institutions to discuss and settle with the concerned developing countries.

Fortunately for this new approach, most of the developing countries in the recent period have entered into negotiations with the IMF and the World Bank and subjected themselves to their discipline. By 1993, it is estimated that almost 90 countries would have adopted adjustment programmes of the IMF. Other international agencies have also been active in designing and supporting adjustment programmes for many of these countries. It should not, therefore, be very difficult for the industrial countries to apply their new aid and development policies as an extremely important complement to the adjustment exercise of these international agencies, without trying to decide separately on the design of the programmes and conditionality.

Even after this, however, there would remain a problem of finding a method by which the industrial countries can judge the adequacy of supply of resources and other development policies related to market and technological access for the reforming country. They also have to decide about the burden-sharing among themselves of the cost of these aid and development policies. It is in that context that we may like to consider a proposal of 'Development Compact' between a developing country undertaking a programme of adjust-

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ment and a group of industrial countries providing the necessary help.[2]

This notion of Development Compact is much more modest than other proposals of 'Development Contracts' made by Mr. Stoltenberg of Norway. These Development Contracts are supposed to be comprehensive long-term commitments by the industrial countries, not only for stabilisation and adjustment, but also long-term development, with a provision of international assistance to help the implementation of broad development plans of the Third World countries. Stoltenberg did not specify the details of his proposal for Development Contract which have been, in some sense, provided by Gerard Adams [3] where he talks about a continued dialogue "in the framework of a new institution, a Development Commission which will deal with the specifics of the policy, monitor performance, and supervise the required revisions".

Our notion of a Development Compact is much looser than a formal agreement, but based on an understanding between the adjusting countries, international financial institutions like the Fund and the Bank and a group of industrial countries. It would be associated with an ongoing Fund-Bank programme, with their stipulated methods of monitoring, supervision and revision. In a sense, these Development Compacts can be considered as an extension of the experiment of the Support Group exercise, which were conducted by the Fund and the Bank to help some of the highly indebted developing countries who fell into arrears with these institutions.

To get out of arrears, these countries were persuaded to adopt extremely stringent structural adjustment programmes. Since the Bank or the Fund could not provide them with any resources until their arrears were cleared as per their Articles of Agreement, they organised Support Groups of donor countries who pledged to provide the necessary assistance for implementing their programmes. The Support Groups met frequently to examine the reports of the Bank and the Fund about the state of implementation of the programmes, deliberated on adequacy of the programme design, the targets and the conditionality as well as the success or failure of the arrear countries in meeting the performance criteria. On the basis of these deliberations, they decided upon the amount of finance that should be provided to the country under programme, and also the method of sharing the burden among themselves.

The Support Group exercise was performed in an ad hoc manner and there

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2 Sengupta, Arjun, "Multilateral Compacts Supporting Economic Reform", to be published in the Companion Volume to the Report of the South Commission.

3 OECD Development Centre, "Towards a Concept of Development Agreement", Technical Papers No. 43, Paris, August 1991.

was no systematic approach to an aid and development policy as elaborated above in place at that time. If, however, there is now general agreement about the tenets of the new approach which we have elaborated, it should not be difficult to institutionalise the Support Group mechanism in the form of a Development Compact. It would not require the creation of a new institution, because, for most of the developing countries, there is already a mechanism of consortium of aid groups, from which a number of industrial countries may be selected to form a Support Group when the country concerned agrees to adopt major adjustment and reform programmes. It would not take much time for this mechanism to come into full operation because it can always use the experience of the existing Support Groups.

III. RESOURCES FOR AID

The success of the new aid and development policy for the 1990s would depend very much on the amount of resources industrial countries would be willing to transfer to developing countries. Development policy related to trade and market access may not immediately involve any net resource transfer, although, eventually, some funding may be necessary if assistance is provided to build up the export capabilities of the developing countries. If the capital and skill formation, implied in the building up of capabilities is financed by grants, it would obviously imply a net resource transfer. If they are provided by private foreign investment or commercial and official credit, there may be an immediate resource transfer that will be compensated by future outflows of dividends, interest and amortisation, whose present value would generally exceed the amount of the immediate resource transfer.

However, in many cases, these flows of investments and credits may have to be promoted with tax concessions and holidays or concessional interest, in which case, again, there would be a net resource transfer. To this, one should add the possible use of structural assistance given by the authorities in the industrial countries to their domestic industries facing competition from the developing countries who are granted free market access. Although this flow of assistance is confined to the domestic economies of the industrial countries, it may be reckoned as a necessary resource cost of following the new policy.

So the new aid policy as described in this paper would imply a substantial additional resource transfer. To the traditional use of development aid, we have added financial flows to provide the assurance for meeting the resource gap in an adjustment programme, together with the amounts needed to meet the unforeseen contingencies, as well as to provide the safety net to the vulnerable groups affected by the programme. This might require a

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substantial amount of resource transfer, depending upon the number of countries accommodated and the length of the programme period during which export earnings and normal capital flows are unable to meet the demand for resources. We should therefore try to identify the potential sources of additional aid.

An immediate implication of the end of the Cold War is the possibility of a reduction in military expenditures, and the likely emergence of the "peace dividend". The Human Development Report of 1992 has identified the possibility of raising $1,500 billion by the year 2000, if military expenditures are reduced by 3 per cent a year during the 1990s. $1,200 billion out of this would come from the industrial countries and another $279 billion would come from the developing countries.

Even if such peace dividends do not materialise to this extent, there would still be a very large scope for generating a large surplus of resources in the industrial countries by a small increase in their rates of savings. The Human Development Report has presented the statistics about global economic disparities which show that the countries accounting for the poorest 60 per cent of the world population had a total domestic investment of less than $300 billion in 1989, which was between 8 and 9 per cent of the total domestic savings of countries with the richest 20 per cent of the world population, amounting to more than $3,500 billion. Assuming that these rich countries have a rate of savings of 22 per cent of GNP, which is the OECD average, only 1 per cent increase in their savings rate, transferred to the poorest countries, could increase the rate of investment of the latter by more than 50 per cent.

This arithmetic indicates the relative insignificance of the magnitude of aid compared to the total claim on resources. The combined GNP of the countries with the richest 20 per cent of the world population in 1990 would be more than $17,000 billion. The official development assistance received by all developing countries in 1990 was roughly $44 billion. An additional saving of a little more than a quarter of one percent of the GNP in the richest countries, if transferred to the developing countries, would more than double the aid flows to these countries to about $90 billion a year.

The diminishing utility of income

The Human Development Report of 1992 has used an ingenious method of adjusting the per capita GDP of the richer countries, in terms of the utility of income, where that utility reflects the well-being of the people, defined as human development. As a country's income per capita increases, the marginal utility of income for that country diminishes. This has been described as the diminishing returns for human development in these countries. Any

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additional income contributes less and less to well-being or human development in those countries.

The Report has specified a minimum level of per capita GDP of $4,829 (in terms of the purchasing power parity dollar of 1989) as the threshold income, up to which there is no fall in the utility of income. Most of the countries of the world have per capita incomes below the threshold, implying their per capita GDP increases directly reflect the well-being of their citizens. The richer countries, however, have higher per capita incomes and the increase in the utility of income is therefore less than the level of income. According to a certain formula, the Report has calculated that major adjustments have to be made in the per capita real GDP for the richest countries, to reflect its contribution to well-being or utility. For example for the USA, the adjusted real GDP was only about 25 per cent of the actual real GDP; for Japan it was 35 per cent, for Switzerland it was 27 per cent, for France it was 32 per cent; for the UK it was 36 per cent; for Italy it was 37 per cent. This implies that for a number of very rich countries, 60 to 70 per cent of their incomes have negligible marginal utility, or that they make very little contribution to the well-being of their own people. [4]

If the logic of this argument is accepted, the case could be made to divert, as aid to developing countries, that part of income in the richest countries which yields only a negligible additional utility. If, for example, 10 per cent of the income of the richest countries were diverted as aid, the amount would be phenomenal: as high as $1,700 billion, assuming their combined GNP as $17 trillion.

Resistance to aid

The fact is, however, that there is great resistance in industrial countries today to any move for increasing foreign aid to developing countries. Many people have serious doubts about the ability of the receiving countries to use that aid efficiently. If the new aid and development policies for the 1990s, as spelt out in this paper, are implemented, this problem could be solved. But then there is still the issue of what mechanism one would have to apply to withdraw resources from exactly those sections of the population for whom

4 Although the extent of this adjustment appears to be a bit too large, it brings out the logic of this approach which seems to be quite reasonable. The level of per capita GDP of $4,829, chosen as the threshold, is derived from a Luxembourg study of the levels of poverty in eleven industrial countries, indicating some sort of a poverty line in these countries, below which the marginal utility of income cannot be falling. If this threshold amount is enough to meet all the basic requirements of living, health, nutrition, shelter and education, an income level exceeding this amount could very plausibly add to the total well-being of the population, or the utility of income, but only by a diminishing amount.

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the marginal utility of income is negligible. A marginal increase in the progressive income tax could produce the desirable effect. If taxpayers could be persuaded of the logic of diminishing marginal utility of income, and if the threshold per capita income can be seen as adequate for meeting most of the basic biological and cultural needs of the population, then a marginal tax, progressing with the multiples of that threshold income may find sufficient acceptance to generate a substantial amount to be dispensed as aid.

Thus, industrial countries could incorporate in their direct tax system a new line of income tax for supporting foreign aid so that every unit, whose income exceeds a minimum per capita income that is needed for a decent standard of living, would be liable to pay a marginal tax that would rise progressively with the difference between its actual income and the minimum threshold income. For example, if the threshold income is $5,000 per capita and the tax unit is a family of four persons, it would pay no such tax up to an income of $20,000, and would pay, say 1/2 per cent on income between $20,000 and $40,000, 1 per cent on income between $40,000 and $60,000 and so on. The exact rates and slabs of the tax would depend upon the size of the units, types of exemption and the nature of assessing the tax liabilities in the different countries. But the principle should be a transparent linkage between the actual income of the tax payer and the threshold income of basic needs, on the assumption that the marginal utility of income sharply diminishes as income exceeds that threshold income.

In principle, it should be possible to build up a new system of international tax liability for the richer countries in accordance with the logic of this argument which could replace the so-called uniform target of 0.7 per cent of income for aid applicable to all countries. In fact, if there is an agreement in favour of such an international tax for foreign aid, it can operate effectively by specifying the liability for each country and leaving it to the authorities of the country to amend their own tax systems suitably. In practice, the possibility of generating such revenues will not be easy. The problems is that most industrial countries are running high fiscal deficits and are trying to reduce the level of taxes. So, whenever a pool of resources can be released, there will be pressure to use it for reducing the level of the deficits. Moreover, there is now a general antipathy against raising or operating with income tax in most of these countries.

IV. CONCLUSION

To sum up, and if the above line of argument is accepted, the following conclusions can be reached about aid policy in the 1990s. First, it should be possible, in principle, to identify potential savings in the richer countries

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which can be diverted to the developing countries as foreign aid at a relatively negligible cost in terms of well-being of the richer countries. Second, appropriate fiscal methods for mobilising such resources can be worked out provided that the authorities in the richer countries follow complementary policies, and that the public at large in those countries is persuaded to transfer part of its income as aid to the developing countries, contributing to the improvement of its own well-being. Third, the way to persuade the public at large of the richer countries to provide such foreign aid would be to make it transparent that these aid funds are being used by the developing countries in areas which promote Human Development or in areas which have the potential of promoting mutual interest. Fourthly, in order that the people of the richer countries have confidence that the recipient countries will make the most effective use of the funds received by them, these aid funds should be used to help them implement economic reform programmes with credibility. When these programmes are implemented within a framework of the discipline of international agencies such as the IMF or the World Bank or other regional development banks, they would appear to be most credible. Attempts to mobilise resources in the richer countries as foreign aid in support of these programmes would then have the maximum potential of success.