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Growth, Aid and Performance

by Dr Edgar Kröllner, Paris

While there was a time—not very long ago—when the notion of “economic stability” was the major aim of national economic policies, the concept of economic growth has in recent years been accepted almost everywhere as the main objective. Naturally, growth may relate to many aspects of a country's economic and social life, such as to per capita income, improvements in income distribution, achievement of a minimum consumption level or given nutritional standards, the eradication of certain diseases, the maximisation of employment opportunities, etc.

What we mean here by economic growth refers to a single, crude, and internationally comparable measure: the growth of output, or, more specifically, of a country's Gross National Product (GNP) or some such aggregates as, e.g., Gross Domestic Product or National Income. Rates of growth would thus refer to the percentage increase from one year to another of total product in volume terms, i.e. at constant prices.

Notwithstanding the wide use and utility of national accounts estimates, they are surrounded by considerable conceptual and statistical problems. For one thing, identifying a country's total output with its GNP is not entirely correct, since an important portion of the goods and services produced—e.g. housewives' services—are conventionally not included in the GNP. Moreover, the output value of some type of activity—notably the non-monetary, largely agricultural sector—has to be imputed which may introduce a large margin of error. Furthermore, there is the general problem of data availability and measurement.

Still, in spite of all these shortcomings the available estimates of a country's total product and its rate of change, are an indispensable tool for economic planning and analysis. Caution is required, however, in order not to over-interpret the existing information.

The Income Gap

If the average per capita income in the industrialised and the developing countries (excluding the Sino-Soviet area) is compared, an enormous, though misleading, gap emerges: about \$ 2,000 per person and year in the industrialised and about \$ 160 in the developing countries. More significant than this gap as such is the fact that it tends to widen both in absolute and relative terms.

In recent years the industrialised countries increased their GNP by about 4.8 per cent per year, the developing countries by about 5 per cent. Since, however, the population increase was about 1.3 per cent in the developed and 2.6 per cent in the developing countries, the annual per capita income increase amounted to 3.5 per cent, or \$ 70 in the developed and to 2.4 per cent, or less than \$ 4 in the developing countries.

Naturally, in both groups there prevail large differences between the individual countries. The per capita income in the developed countries ranged from \$ 3,500 for the USA to about \$ 400 for Portugal; in the less-developed countries from over \$ 1,000 for Israel to about \$ 50 for Ethiopia. Between the growth rates, too, important differences obtained, but these will be discussed later.

It goes without saying that the wide gap between per capita incomes is no reflection of an equally wide gap between the standard of living, e.g. in the sense that the average American lives 70 times as well as the average Ethiopian. Still, the large differences in the per capita income between the developed and the developing countries constitute a disturbing element within the international community, and energetic efforts are warranted on both sides to gradually reduce this disparity.

The Magic Triangle: Growth, Aid, Performance

No attempt will be made here to review the different growth theories which have attracted much attention during the past decades. Nor will we deal with all the different ingredients to growth—labour, capital, natural deposits, climate, cultural attitudes—but confine ourselves to the relationship between investment and growth.

This relationship seems to be one of the central issues of economic development and implies that a certain measure of growth depends upon a certain measure of investment. Its quantitative expression is the capital-output ratio which specifies the number of units of investment held to be necessary to raise the level of production by one unit per annum. If the capital-output ratio is, e.g. 3:1, 15 per cent of the GNP would have to be invested to obtain a growth rate of 5 per cent per annum. The capital-output ratio is thus a shorthand device to express the efficiency of investment, taking into account also the effect of all the non-capital factors on growth, such as improvement in techniques, skills and organisation.

Investment is financed from two sources: domestic savings and external assistance. The self-help performance of less-developed countries shows up mainly in the degree to which domestic resources are mobilised, i.e. in the savings effort, and in the degree of efficiency of investment of both domestic and foreign resources.

These three elements—growth, aid, performance—can be combined into a “magic triangle” to show their intrinsic relationship. Clearly, the growth rate is the higher, the larger the volume of aid and the better the domestic performance. Efficient development policy then means to blend aid and performance into a mutually reinforcing relationship to maximise their joint growth impact.

The Growth Target

In designating the 1960's as the United Nation's Development Decade, the UN promulgated in 1961 a development target for the less-developed countries: the achievement of “a minimum annual rate of growth of aggregate national income of 5 per cent at the end of the Decade”.

This target is both arbitrary and ambiguous. It is, e.g. not clear whether an average, incremental or terminal growth rate is aimed at, or whether this target is applicable to each less-developed country or to all the less-developed countries as a group. Nevertheless, it has been widely accepted that development policy should be based on at least certain minimum aims. While it may not be possible, or too costly, to raise the GNP of each less-developed country by 5 per cent per year, as many of these countries as possible should have a sense of real economic progress, notably in terms of a perceptible increase in per capita income.

If the period 1960-65 is taken as basis, the annual growth target of 5 per cent has been achieved for all the less-developed countries as a group (including the European less developed countries with their considerably higher than average growth rate), but wide discrepancies prevailed from one country to another. Still, nearly all of the developed countries have succeeded in achieving some economic growth and some of them have experienced a degree of economic expansion which was much larger than in any of the industrialised countries. It should be remembered that this growth performance is a relatively recent phenomenon in the history of the less-developed countries which are hence not caught in the low per capita income trap as some gloomy economic theories assert. While their rate of growth may not yet be satisfactory, there is every indication that the historical pattern of stagnation has now been broken.

The Aid Target

At the United Nations Conference on Trade and Development (UNCTAD) at Geneva in 1964, an assistance target was accepted recommending that

“each economically advanced country should endeavour to supply... financial resources to the developing countries of a minimum net amount approaching as nearly as possible to 1 per cent of its national income...”. External assistance was defined to include both public and private flows, net of amortisation (but not of interest). This recommendation was reinforced in 1965 by the Development Assistance Committee of the OECD.

This aid target, while it would lead to some increase in assistance by some countries, is also highly arbitrary. It bears no relation to the assistance requirements of the less-developed countries, nor to the growth target of the Development Decade.

The assistance record of the donor countries in 1960-65 shows that while all the donors as a group have provided a total net flow of resources amounting to slightly more than 1 per cent of their combined national income, wide differences in the degree of achievement of the aid target exist between the individual countries. The contributions of France, Belgium, the Netherlands and Portugal have been considerably higher than the 1 per cent norm; other countries have remained far below it.

Moreover, whereas the total assistance flow has reached a new record in 1965 with over \$ 10,000 million, the increase in the past two years has been almost exclusively due to rise in the private flow; public assistance has not only stagnated, with about \$ 6,000 million per year, but has suffered a deterioration of its terms and conditions with regard to interest rates and repayment periods. The aid flow in 1966 showed a decline to about \$ 9,900 million, due to a drastic drop in the private flow—especially from the United States—which more than offset an increase in official assistance to \$ 6,400 million. (These figures are net of repayments and refer to OECD countries only; East Bloc aid was around \$ 500 million per year in recent years.)

In the last analysis, however, both the aid and the growth target are not too important. What really counts for economic growth this not a mathematical relationship between two aggregates but the political will to give assistance, on the one side, and the national will to develop, on the other side.

Why no Performance Target?

Since growth is determined by both aid and performance, it would not be illogical to ask why there is a growth target and an aid target but no performance target.

In this context it should be noted that—whatever the underlying motives may have been—the importance of performance for growth has been explicitly recognised by the less-developed countries at UNCTAD. Recommendation A. IV. 1 mentions in particular “the importance of well-formulated and workable development plans and programmes and of adequate measures by the developing countries for their implementation.

In this regard, the developing countries should seek to mobilise internal resources to the maximum extent possible: by promoting educational and technical training; by diversifying production and encouraging improved techniques in industry; by promoting increased productivity and output of agriculture by measures including land reform where necessary; and by employing monetary, fiscal and other policies, including tax reform where necessary, designed to increase and mobilise domestic savings and foster investment."

As to the measurement of performance, however, the problem arises that the needed self-help actions of different countries cannot be assessed on the basis of any single set of factors, because there are different constraints on growth in the different countries, warranting different steps towards their removal. For this reason, attempts to rank countries with respect to selected performance indicators—e.g. the growth rate of product, the marginal savings rate, the marginal capital-output ratio, the growth rate of exports—have not been satisfactory since a country may perform well under one and badly under another criterion. For example, a low savings rate and a high capital-output ratio may reflect not only such factors as poor attempts to mobilise savings, bad planning, and inefficient utilisation of capital, but also structural conditions (such as paucity of resources), as well as indirect effects of failure to increase export earnings and inadequate or ill-conceived promotion of import substitution. While all these indicators are relevant to an adequate appreciation of performance, they only begin to add up to a coherent and comprehensible picture of the situation when a way is found of combining them within the framework of an organic, articulated analysis.

Another source of difficulty in evaluating performance is whether to judge (subjective) effort or (objective) achievement; or whether to evaluate the absolute level (in some sense) of a country's performance or merely its improvements over the past level.

These complex problems of measuring the performance of the less-developed countries are in sharp contrast to the relatively straightforward method of quantifying the growth rate achieved by the less-developed countries, or the assistance effort of the donor countries, e.g. by expressing the aid flow as a percentage of national income. This conceptual difficulty of measuring performance, together with the delicacy inherent in imposing self-help measures on the typically sensitive governments of the less-developed countries, are the main reasons why there has emerged a growth target and an assistance target but no performance target.

Economic Growth and Assistance Requirements

While the assistance target is based on a supply approach towards the aid-cum-growth relationship, demand estimates of assistance requirements have in recent years attracted much attention. The most

popular of these "gap" calculations was the one put forward by Dr Prebisch at the 1964 UNCTAD. This was a global requirements estimate for all the less-developed countries as a group; it projected for 1970 a total balance of payments gap of \$ 20,000 million to be met by both external assistance of the developed countries and improved self-help (notably export) performance of the developing countries.

The Prebisch gap is based on an average growth rate of the less-developed countries' GNP of 5 per cent per year—the UN Development Decade target. It assumes that, to sustain this target, their imports would have to increase by 6.5 per cent per year. Since their exports, on the other hand, being mainly determined by the demand of the industrialised countries, are not expected to increase by more than 4 per cent per year, there would emerge a gap which would increase to \$ 20,000 million by 1970.

Similar target-type gap estimates, though with different methods and results have been undertaken by Lewis, Balassa, Maizels, Rosenstein-Rodan and others.

Some of these estimates concentrated on the investment-savings, rather than, as the Prebisch estimate, on the import-export gap. Both gaps are, of course, equal after the event since both indicate the volume of resources which an economy has used in excess over the resources which it has produced. In view of this ex post identity of the two gaps, it is all the more interesting to note that those authors concentrating on the import-export gap arrived at pessimistic conclusions, i.e. an increasing gap, since imports are assumed to have to rise at least as fast as GNP, hence by at least 5 per cent, while exports grow more slowly. Alternatively, the investment-savings approach leads to more optimistic results, i.e. a narrowing gap, since the marginal savings rate is assumed to exceed the average savings rate and eventually also the required investment rate.

A totally different gap approach was adopted by the World Bank when President Woods declared in 1965 that "a preliminary Bank inquiry, carried out country by country and based on the judgement and experience of the Bank's country specialists and area economists, suggests that the developing countries could effectively use, on the average over the next four years, some \$ 3,000 million to \$ 4,000 million more of external capital per year than has been provided in the recent past".

Clearly, this is a radical departure from the growth-target-type approach, and based on absorptive capacity limitations of capital inflow. The key word in Mr Woods' statement is "effectively". To be economically meaningful this must be based on some concept of the rate of return on capital. Since—possibly after a "big push" phase with more than proportionate returns—capital investment is held to encounter diminishing returns, the cardinal question is: on what minimum cut-off rate of return is the Bank's \$ 3,000 to \$ 4,000 million figure based? Would

further assistance, i.e. beyond the additional \$ 3,000 to \$ 4,000 million a year, have no further positive impact on growth? And has the same underlying cut-off rate of return to be applied to all countries? These are the essential issues, but here we remain in the dark.

In conclusion, it should be stressed that gap projections rest essentially on four types of problems: (1) on the notion that a growth in income is functionally related to a growth in investment, i.e. that development can be "bought"; (2) on the complex difficulties with respect to data availability and the inter-temporal and inter-country stability of parameters which surround all quantitative models and projections; (3) on value judgements regarding the growth target which capital-providers are willing to finance or the cut-off rate of return on capital which they are willing to accept; and (4) on what type and degree of self-help performance the developing countries would undertake and hence what residual share of investment requirements is left for external financing.

Growth and Assistance Allocation

With regard to the allocation of assistance to the different aid recipients, donors face the crucial choice whether to apply the same growth target or the same cut-off rate of return to all the different countries and whether to adopt "efficiency" or "need" as the guiding principle of their assistance distribution; for those countries which, because of their poverty, need aid most are usually not the ones which can use it most effectively.

The suggestion has been made that external assistance would be used with optimal efficiency if it is concentrated at any given time on a small group of near-take-off countries. These would be those with a fairly developed infrastructure and a high marginal savings rate. A rapid increase of their GNP through a massive aid inflow would generate significant domestic savings which would be ploughed back to investment with a further subsequent growth effect. In this way, these countries could be brought fairly quickly to the stage of "self-support", or "self-sustaining growth" whence their economic development would be financed from domestic sources with no further dependence on non-commercial capital inflow. At this point, aid would be concentrated on a new group of near-take-off countries. Other developing countries would be helped mainly by technical assistance to provide the skill and infrastructural basis for a later stage warranting massive capital assistance. While this may possibly be a rational and economic way of aid allocation, over-riding alternative considerations, such as political and commercial links but also response to need, make its adoption highly improbable.

The Central Factor of Performance

While external assistance makes an important contribution to development, the self-help efforts of the developing countries will always constitute the main

basis for economic growth. In fact, about four-fifths of their capital formation is financed from domestic resources.

Performance, however, has many faces. The usual stress on the mobilisation of resources in the form of savings may not meet the key problem in several countries; savings, e.g. may be frustrated by lack of investment and export opportunities. Hence, efficiency in the utilisation of domestic and foreign resources is another, at least equally, important performance element. Moreover, good performance may show up in sound development planning, in good project selection and execution, in the efficient balance of payments (including debt) management, in regional cooperation, in population control, in agricultural development, in the success of attracting foreign capital, in retaining public order and eliminating corruption, in avoiding warfare, and, in the widest sense, in transforming a country's socio-cultural basis from an irrational and traditional system of values towards a progressive and success-oriented society.

However defined and measured, performance is thus of crucial importance for the amount of assistance required to secure specified developmental results or, alternatively, for the developmental results which can be secured with a given amount of assistance. Aid donors, therefore, seek to identify those aspects of a recipient country's performance which are both capable of improvement and significant for the efficiency of economic development and the use of assistance.

Donor-recipient relationships with respect to performance may take the form of formal agreements on "incentive programming". This means that the assistance-provider makes the release of a specified amount of aid dependent upon the achievement of certain pre-stipulated performance measures. While this approach is still in a somewhat experimental stage and confined mainly to some phases of US assistance, all the aid donors realise increasingly the need for co-ordination among them. Concerted efforts to improve development performance of recipient countries are called for lest the efforts of one donor would lose its leverage if other donors emphasise different aspects of performance or if some give aid without any concern to self-help contributions.

If the rapid economic development of the "third world" is to be viewed as a joint challenge of aid donors and recipients, nothing can be gained from a sterile confrontation whereby one side stresses "aid" and the other "performance". Instead, donor-recipient relations should be freed progressively from disturbing emotional elements which obscure the underlying mutual dependence. Enlightened self-interest and a clear recognition of the legitimate national concerns of both donors and donees would go a long way in demystifying the assistance complex and in putting it on a more sober, rational and effective basis.