CHAPTER II
LITERATURE REVIEW

This chapter comprises three main sections: the Cold War followed by the Post Cold War era and a last section for a summary of the literature findings. The first section, described Taiwan's experience along with the evolution of the idea of foreign aid to economic growth pattern. Theories as Keynesian "trickle down" during the 1950s and 1960s, dependency surge, the modernization theories reemergence, as well as the United Nations Structural adjustment for poor countries kept the lead. Burkina Faso is the showcase of the 1990s and 2000s with emphasis on conditionalities, human capital and the basics needs theories.

II.1 COLD WAR ERA

II.1.1 BACKGROUND ACCOUNT

In the aftermath of the World War II, the political freedom of many Third World countries happened in an environment politically undermined by the cold war. These countries shifted from the colonization trap to the "low-level equilibrium trap", or "the vicious circle of poverty."[1] The researchers and multi sector analysts focused their attention on the study of the economic development of this new cohort. During the 1950s to1960s, modernization and structural theorists went for different analysis concerning this issue. For the orthodox economists, including Keynesian and neoclassical theorists, the Harrod-Domar, two gaps, financing requirement model, or Aid financed investment approach to development was the key to launch the economy growth process in those late comers' countries.[2]

This theory has emerged from John Maynard Keynes 1930s idea that Government could stimulate development through financial investment. Economists therefore, had suggested that cash inflow from overseas

[1] It holds that poor countries are hopelessly so because of a cycle of low productivity, low output and low savings. For more information on the subject, confer Paul Mosley and Arjan Vershor, « Risk Attitudes in the Vicious Circle of Poverty » Professors of economics university of Sheffield: www.chronicpoverty.org/pdfs/conferencepapers/Mosley/pdf.

[2] The main policy implications of this model are that economic growth requires policies that encouraged savings and/or generates technological advances with lower capital/output. Some of the critics of this model mentioned the fact that borrowed from oversea to fill the saving gap lead to a cumulated debt issue. Lewis model is structural change model that explains how labour transfers in a dual economy. http://www.tutor2u.net/economics/content/topics/development/development_models.

into Least Developed Countries (LDCs**)** could stimulate the investment. In brief, this early view sustains that as developing countries lack the necessary saving to finance investment, foreign aid can help to bridge the savings-investment gap. Doubts raised about the efficiency of this theory from the beginning includes worries that foreign aid may substitute saving, while aid flows may be treated as an increase in income and used to raise consumption. More critics from the structuralists went further in advocating for a limited South-North interaction to allow the former to undergo its own development process. During the 1960s, they sustained that the South's poverty is due to the North's wealth. Most of the structuralism scholars raised some doubts about the gap theory efficiency.

The limited results of this theory happened mostly in Central America and Sub Saharan Africa. This turn has precluded the emergence of the modern development pioneers including Rodan, Chenery, Hirschman, Leibenstein, Lewis, Myrdal, Nurkse, and Rostow. [3] Against the orthodox theories of-all-to-finance recommendations, development pioneers argued that the persistence of the structural constraint the effectiveness of the orthodox financial policies. Considering foreign aid flows, they proposed the two gaps theory of Chenery and Strout in the early 1960s.

It stipulates that, besides the saving gap to be filling by foreign finance, a foreign exchange gap for purchase of foreign good, needs also to be equally filling from the same funds if the Third Word countries have to grow at rates commensurate with industrialization.[4] Moreover, aid is to provide for a takeoff into self-sustained-growth but not for a redistribution of wealth.[5] It assumes a linear relationship aid-investment-growth

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3 Walt Rostow 5 stages are: (1) the traditional society, (2) the long period when the preconditions for growth evolved, (3) the relatively short period of take-off into self sustaining growth; (4) the rapid drive to maturity; and (5) the era of high mass consumption. Idea published in 1960: *the Stages of Economic Growth: A non Communist Manifesto*.(Katie Willis, 2005), P.39.

4 Bazoumana Ouattara, "The Impact of Project Aid, and Program Aid Inflows on Domestic savings: The study case of la Cote d'Ivoire", *School of Economics Studies*, University of Manchester, UK, .4/ The Harrod-Domar model , stipulating that there is a fix relation between the growth of the output, and the growth of the capital stock. In other terms, the incremental capital output-ratio is constant, and similarly, the aggregate saving within the economy is s a function of national income given interest rates, acting as a channel for saving out of the country.

5 Irma Adelman and Cynthia Morris, "development History and its implication for development theories" www.berkeley.edu Chenery Hollis, and Strout paper details are listed on the bibliography at the end of the document

over the short to medium term in which aid financed investment but not consumption. Was that the case in Taiwan?

II.1.2 TAIWAN EXPERIENCE

The bulk of the scholars moved by Taiwan’s economic development followed the trend design by the leading schools of thoughts: from developmental, dependency, to statist theorists. If for the two pioneering groups of scholar external factors are worth to explain this impressive achievement, the third school labeled statist, bolded Asian particularity, and government skillful interventions in the process of economic development. Taiwan along with the three others East Asian Dragons has been a showcase for the modernization school and the gap theorists. The earliest explanation for the Island economic development success stressed the role of the external funds, and technical assistance received by the country in the 1950s.

In that sense, Jacoby is the pioneer of a complete research on U.S. Aid implementation in Taiwan. He is a pioneer in applying the two gap-theories to Taiwan study case. He has estimated for a less or more stagnated growth of rate without U.S Aid based on the lack of enough foreign to afford investment, capital and consumer goods imports. However, his work also advocates for the importance of the domestic’s factors as to echoes Scott’s view sustaining that: “Aid plaid an important role in helping to control inflation in the early 1950s…, that helps political stability …, enable a soon recovery Influencing the choice of economic policies at a crucial time…, aid was important but so were other factors.[6]”

Indeed, in the aftermath of Jacoby’s book, the scholars of the 1970s while criticizing the limited nature of his quantitative analyze, have otherwise, more or less acknowledged his findings as stated here: “It can hardly be imagined that, in an economy devasted by war and with ensuing large trade deficits, any significant progress could have been made without foreign aid. This is not true only for Taiwan but also largely true for postwar Western Europe and Japan.[7]”

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[6] Maurice Scott, “Foreign Trade”, *in Economic Growth and Structural Change in Taiwan: The post War Experience of the Republic of China* ed. W. Galenson, (Ithaca and London: Cornell University Press, 1979), P.372.

[7] K.Y.Yin "A decade of US Economic Aid and Economic Development in Taiwan" *industry of free China*, (Maurice Scott, 1979,372)

The core of studies summarized by Maurice Scott includes Lin (1967); Kuo, Tang and Liang, (1974); Scott, (1975);[8] Yager, (1988); Li, (1976); King, (1990); and Lee, (1990) have particularly underlined U.S. Aid primary role in agriculture development and the unique character of the JCRR as foreign aid implementation structure. Lee, on this subject, wrote; "The JCRR advised and monitored land reform during 1949-1953. It streamlined and democratized the farmers associations. It improved rural health conditions. It later fostered improvement in technology for water resources, agricultural crops, livestock, forestry, and fishing."[9]

During most of the late 1970s to 1990s Taiwan experience account became mostly pro-statist. The bold factors of this impressionable experience include the leadership of Chiang Kai-shek and the ruling party expertise in economic development planning. It includes Gold, (1986); Dickson, (1993); Hood, (1996); Clough, (1996); Fulda, (2002), the Confucianism and the thought of Sun Yat-sen with Gold, (1986); and Myers, (1986). The Japanese legacy Clark, (1989); Ranis, (1978), good, flexible planning Clark, (1989); Lau, (1986), the quality of population in terms of educational levels Lau, (1986); Ranis, (1978); Shen, (1964), land reform Lau, (1986); Ranis, (1978), a favorable confluence of world economic and political conditions: Amsden, (1979); Gold, (1986); Myers, (1986).

While the first stream of the late 1960s 1970s scholars were converging towards external factors, the late 1970s to 1990s scholar went further on stressing inward oriented factors of development where both human capital and U.S. Aid are mere factors among others to Taiwan "economic miracle". There is almost no direct mention of human capital as defined currently, but of investment in human resources. An investment fuelled through formal education primary by Japanese colonial government and after the WWII by Taiwan government. This governmental policy was particularly strong in 1968 with the nine compulsory education policies in Taiwan (for all pupils under 15 years old).

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8 Idem: the author provides detailed information concerning the above mention authors as followed: H.T. Lin, "US Aid and Taiwan's Economic Development, in *conference on economic Development of Taiwan* (Taipei, June 1967), 306. A.M.Tang, and K.S.Liang,, "Agricultural Trade in the Economic Development of Taiwan" *in Trade, Agriculture and Development*, ed.G.S. Tolley and P.A. Zadrozny (Cambridge:Mass, 1974)

9 Edward Lee, The JCRR: "A model for development Aid" in *Development Aid: what works, what doesn't* (selective papers), *Center of Area of Studies*, Taipei, Taiwan (ROC), Tamkang University 21-22 January, 1990, P.19.

The study of the impact of this educational reform by Sophr, (1999); found that Taiwan's education reform of 1968 did have an impact on the workforce, particularly in the rural areas. Tien, (1996) article reinforced this finding. She stipulates that this period is remarkable for the quick expansion of primary and junior high school, the diversification that includes new fields as vocational education, junior college, teacher training, higher education, graduate education, evening schools. All guided by the well-fitted education-to-economy-planning of the government. However, studies more and more addressed the fundamental question of how formal schooling might determine individuals' labor market. The 1968 expansion of compulsory schooling occurred at a critical juncture of the economic transformation.

From the 1980s, indigenous growth, theory brought human capital as central engine of growth for countries. Taiwan is not an exception. Following scholar as Lucas, (1988) and (1993); Romer, (1990b), Meir, (2000), formal education, on-job-training, learning-by-doing, and improvement in health and nutrition attracts attention from econometric analysis as important measure tools for human capital. Ranis, (1992); Wu, (1993); Haggard, (1996), Chuang (1999); Sophr, (1999); G. Greene, (2000), Lin (2004) recent studies integrated these multiples dimensions of human capital.

Their findings reveal the importance for both government and private investment in education, and the ensuing spillover effects to other sectors of the economy. These latest studies are worth to understand the current impact of human capital investment in economic development. However, they have a relative importance concerning the particular case of Taiwan in the early 1950s to 1960s. For these specifics times, Initial Conditions including Japanese development, Mainlanders high quality immigrants, salvage from the Mainland (94000kg of gold and 355000 kg of silver), are cited along with external conditions of U.S. Aid the fact that this development occurred during a global economic boom. To make clear the whole idea, let shifted to the Post Cold War era where studies interest for Burkina Faso and similar poor countries has increased.

II.2 THE POST COLD WAR: FROM 1990s

II.2.1 BACKGROUND ACCOUNT

The collapse of the socialist block and economic stagnation of the 1980s and 1990s has brought human rights and humanitarian concern back as central issues. Neo-liberalists are leading economic and development spheres. The two-gap model remain accurate but with important changes from its initial content.[10] The original formulation of the theory considered foreign finance as aid or grant. From the 1970s with a particular pick in the 1980s, the foreign aid content shifted from this early formulation to be mostly loans and credits than grants. Moreover, fundamental changes including the introduction of the HDI as main variable of the UNDP human development computation conferred a multidimensional character to development studies issues. It has increased concerns for education, water access, non-polluted environment, and social capital.

Currently, development is a process for the mobilization of economic, socio cultural, and all potentialities of a country, region or community.[11] As Dollar and Easterly put it from their study of the subject, the inventors of this model have confidence in two mediums run links. They believe in aid as investment, and that investment should inevitably lead to growth. Author's test provides four main conclusions:

> Firstly, aid does not necessary financed investment, and investment does not necessary lead to growth. Secondly, differences in economic policies can explain much of the differences in growth performances, poor quality of public services, closed trade regimes, financial repression, and macroeconomic mismanagement. Third, country ownership of reforms is most important than conditionality of donor country. Four, foreign aid cans therefore plaid a supporting role in bridging ideas, technical assistance, and money. Combination of private investment, good policies, and foreign aid is the ideal to achieve economic growth in those countries.[12]

Even though, this model is considered as outdated and unable to address the Less Developed Countries development needs, it remain a fundamental tool for the economists of the international institutions as they try

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[10] In general, the neo-liberalists of the post cold war remained convinced that the developed countries can filled the financial gap in the developing countries that in turn would allowed them to have enough foreign currency to import capital and consumers goods.

[11] Recently, the Millennium projects economists have by a conventional form of financial gap calculation concluded that meeting the Millennium Development Goals will required a surplus external funding per capita of (US$) 40 to 50 for Least Developed Countries in 2006, and 70 to 100 until 2015.

[12] David Dollar, William Easterly, "Aid, Investment and Policies in Africa", *Development Research Group Bank*, (2000), P. 2 www.worldbank.org/htlm/publications/Workpapers/

to find empirical facts and workable solutions.

Among them, Isham (1997), Hadjimichael and al (1995) White and al, (1998 and 2005) have empirically tested the evidence of whether or not the invested funds have so far contributed to the recipient countries growth. Their findings firstly show that in mean, an increased in aid come about with rapid growth but do not established whether or not aid has always been efficient.[13] Secondly, that aid is effective under particular conditions, the nature and aims of foreign donators, and domestic's characteristics of the recipient countries. In the same vain, but with different results, Burnside and al, 2000, have used a database on foreign aid to examine the relationship between foreign aid, economic policies, and growth per capita.

They found that Aid is effective in countries with good policies environment. This optimistic voice is in symbiosis with current aid advocates as Jeffrey Sachs (current Director of the Millennium Project), Joseph Stiglitz, and Nicholas Stern. Based on countries economics growth variables, they concluded that in spite of some failures, aid grant observables results in some countries, while containing poverty rate in some others.[14] Replying to critics against recipient countries, this group of economists has argued that donors are also responsible. Aid, they underlined, was mostly used by the donor's countries to entertain political ties but not to promote development. Aid even fungible has some effects on poverty extension and degree. Education and health variables increased comparing to the same length of time of other periods. More recent empirical studies on the question conducted by Islam, (2003); Clemens, Radelet, and Bhavnani, (2004); Rajan, Subranian, (2005), are innovative studies as they include new dimensions in they results interpretation.

Islam has identifies three kinds of aid with different effects. The first type is the Humanitarian *Aid for urgencies and catastrophes* characterize by a simple negative correlation. The second is the Aid for environment protection, education or health Observations. This type of aid is negative in short term but promising for the long term and the third is the aide allocated for growth in a short period. A length of time indicate for Construction of road, harbor, energy power, irrigation system, agriculture, industry and services

[13] Cf. bibliography
[14] Burnside C. and Dollar D. "Aid, Policies, and Growth" *American Economy Review*, 2000, 90: 847-68

Monetary aid as help to the budget. This rapid effect aid investment constituted half of the aide influx.[15]

The latter's has bolded this characteristic of the allocated funds. Rajan and Subranian, (2005b), while trying to clarify doubt concerning aid-growth positive correlation, would not find a robust proof otherwise. They have witnessed the fact that so far, good examples on foreign aid can be backed to the Marshall plan in Europe, Mozambique or Uganda in Africa, and Korea in Asia (Taiwan albeit its plain success had not been mentioned). These successes were due according to the mentioned authors, to institutional capabilities and people's education. It appears that poor countries are short of resources and unable to put aid inflows to good use: in brief, a low human capital matters. This conclusion echoes to main critics against foreign aid efficiency.

For those scholars and non scholar as well, foreign aid delivers are hypocrites, while recipient countries leadership are corrupted, and unable to initiate wise and realistic strategies for development. Highly disabused by the low results obtain from aid implementation in the poor countries a growing scholarly literature mainly developed from the early 70s to 90s and based on empirical studies still awake. Writers as Boone's and Easterly, 1996, concluded to a limited relationship between Aid-Investment-Growth in recipients' countries. This aid policy they asserted, favor complaisant allocation of aid and have a bad effect on domestic economy growth.[16] Sogge and De Rivero, (2003); are among critics of this institution.

However, a noticeable changed in their arguments is perceptible. They are no more urging for any North-South relation cessation, but tend to suggest a new way for a realistic use of aid funds in poor countries.[17]. In this sense, one can observe that both critics and advocate of foreign aid disbursement consensually agreed that institutional capacity and people education are worth to scrutiny analysis. Burkina Faso experience account acknowledges the renewal will of both internal and international actors for the poorest countries of the world.

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15 Muhammad Islam Muhammad, "Political Regimes and the Effect of Foreign Aid on Economic Growth" *The Journal of Developing Areas Concordia University*, 37 (Fall 2003), P.18.

16 Aid (they sustain) encourage corruption, reduce private sector opportunities growth, money appreciation, less profit on consumption, reduce agricultural products and laborers income, weakened public and private saving, maintain bad governments and inappropriate economics policies for long time.

II.2.2 BURKINA FASO EXPERIENCE

A general literature produced by Europeans, African and Latin America historians, sociologists, economists discuss Africa and Latin America underdeveloped countries economic stagnation issue. For economists including Amin, (1970); Emmanuel (1969); Cardoso and Faletto, (1978); the leadership blockage of development, dependence in trade, capital, and technology are major constraints to be overcome. In conclusion, they sustain the idea that underdeveloped countries should rely on their own forces through capital accumulation from agriculture surpluses; used these surpluses for industrialization; and adopted wise and smart State plan strategic economics sectors and coordination. Foreign aid should allow wide freedom of implementation.[18]

For humanities bound scholars as Dumont, (1973), Ki-Zerbo (2004), among others, the real constraint of the continent is its ill-thought political economy and African acculturation. In response, the international structures**,** agencies of the United Nation, socially oriented structures advocated for more pro-poor investment of aid with the intervention of Non Governmental Organizations (NGOs). Neo-Malthusianism stipulated for its part that it urge to control the economic growth resources, and the population growth to avoid economic and ecological disaster. Specifics studies related to women development, environment care and concept of sustainable development spread over the 1980s, with many initiatives from both sides, and meager results for Burkina Faso[19]

Englebert, (1996); Olaniyan, (1996), Madiega, (1995), Batenga, (2006), mentioned the political instability, and the poor economical variables of Burkina Faso as well as the debt incidence to its limited economic progress. The international community and bilateral cooperation structures reports and working papers show an important increase of interest for Burkina Faso from the late 1990s to a current high point with the MDGs renewal aims and strategy redirection in the early 2000s. According to the World Bank data,

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18 For more information on European Literature about the subject, cf. Louis Favreau, « Économie sociale, cooperation Internationale et developement des pays du sud », www.uqo.ca/corps-professoral/prof/**favreau**lou.asp (acess, February 5, 2006).

19 This includes institutions as UNESCO, ILO, OMS, FAO, PNUD and international economic institutions of FMI, WB, GATT (WTO currently): www.un.org for more information.

currently, many actors are involved in Burkina Faso ODA inflows. The European Commission and European Union Member States (France, Belgium, Denmark, Netherlands, Germany, Luxembourg, Sweden, Austria, Italy, the World Bank and United Nations system, Switzerland, Canada , Japan , Taiwan and Arab countries are the principal actors .

The Poverty Reduction Strategy Paper (PRSP), the principal reference to public development aid, guides both bilateral and multilateral actors.[20] While European Union cooperation recalled back to the late 1950s, the Breton Woods institutions represented by the International Development Agency (IDA), The International Monetary Fund (IMF), the World Bank came strongly into the scene by the 1980s, the structural adjustment era. When the structural adjustment appears to be a real burden for the Least Poor Countries, the PRSP enhance the economy of the High Indebted Poor Countries (HIPC).[21] Since 2002, a common institution denominated the "SBC-CSLP (a joint initiated structure to strengthen domestic's government budgets).[22] This common approach is supposed to come-up with the most efficient results for poverty reduction.

Most of the international literature concerning Burkina Faso suggests that poverty did not decrease during the last ten years but stagnated at a high level, with roughly 45 percent of the population been poor. The papers from Konate and Raffinot, (1998); Savadogo, Coulibaly and McCracken, (2002); Hugh Waddington and al, (2003); Richard Gester, and Kimseyenga Sawadogo, (2003); Waddington (2003); Grimm and Gunther (2004); Louise Simonsson (2005); used cross-countries, country political and macro economic data evolution, to alight the persistence of a permanent poverty pattern and light macroeconomic changes. Grimm and Gunther addressing this recurrent pattern have found that:

1. Aid-growth pattern in Burkina Faso has improved positively since the mid 1990s but can be more pro-poor.
2. Growth during the last decade was underwritten by cotton export, and by secondary and tertiary sector with a small percentage of Burkinabè workforces.

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[20] The Poverty Reduction Strategy Paper (PRSP) is known in Burkina Faso as the "Cadre Stratégique de Lutte contre la Pauvreté".

[21] Fourteen countries from which 31 are from the Sub Saharan Africa are included in the High Indebted Poor Countries program. Currently, 19 of these countries including Burkina Faso have reach the requirement for debt forgiveness, 10 is waiting for a final decision, and 11 others still under pre-decision procedure.

[22] In French, "Soutien Budgétaire Conjoint au Cadre Stratégique de Lutte contre la Pauvreté".

3. The economy segmentation and cross-national markets limitations that could to some extent lead to spillover effects.
4 The French African Community, currency devaluation was positive to sectors akin to international and domestic trade but poor to-not-to trade rural and urban population.
5. In rural areas, the notion of risk-aversion explains the low pro-poor growth.[23]

Official updates of the country economical development strategies, and evolution from Ministries of Finance and Plan, May 1993; Ministries of Economy and Development, August and September 2003; September 2003; July/January (2015 forecasting), 2004, confirmed the above literature. Their description identifies the main constraints of the process:

1. Weakness in domestic resources mobilization
2. Difficulties on external aid fundraising and inefficiency in its domestic management
3. Weak economical infrastructure
4. Weak Human Capital
5. Weakness on rural population care
6. Inadequate public policy
7. Inefficiency of current strategies for rural communication and development
8. Weak contribution of the private sector

From the above key constraints, Burkina Faso appears as a country with limited financial resources, low physical and human capital. All these factors are therefore, worth to be considered in any analysis concerning the country economic development. Facing so many tasks there is a need to care for the “angle stone”.

II.3 LITERATURE FINDINGS AND PROSPECTINGS

The above literature review teaches that the two-gap theory to fill saving and foreign exchange gaps remain central to the international community intervention in the LDCs. This model in its initial formulation defined foreign aid as mostly grants coupled to a relevant technical assistance from the donor country. The model implemented under this definition has been more or less successful in Taiwan and East Asia countries. However, the same model implementation in Burkina Faso and LDCs occurred at a time where the delivered funds are mostly loans, and credits. This fundamental change occurred in an era of increased concern for investment in social infrastructures, which requires much more grants funds than loans.

[23] According to the CIA country profile, in 2005, 90 percent of the 5 millions of labor force are employed by the agriculture sector.

Taiwan experience along with South Korea, Hong Kong, and Singapore described as a successful case by most of the international economists appears as a success for the two-gap model application. Most interestingly, the stress of the government skillful intervention in the process, and the implementation of aid policy by a semi-autonomous structure underlined by most of the statist writers, has also affected the process. Current users and advocates of the two-gap theory are waiting for a short-run return on investment, and willing to undergo a result-oriented policy. Therefore, time seems up for more responsibility firstly for the international community itself, and for both external and local actors involved in the process.

Burkina Faso experience shows that since the 1970s, funds went peace meal to some social sectors and infrastructures. It also shows political stability and full cooperation of the Burkinabè leadership since the 1990s. What it does not show is a clear aid autonomous or semi autonomous aid policy institution, which, in the case of Taiwan, helped to focus investment firstly on the human capital formation. The next chapter describes through content analysis how it works for Taiwan.