of radical and often painful adjustment, and on the resources available to help manage those adjustments. Political leaders can influence the pace of reform, although not always by as much as many of them like to imagine, if they can establish credibility in their programmes and create and sustain a popular consensus for change behind a positive vision of the society at which they are aiming. They will also need to make candid estimates of the likely short-run costs involved, not promising a "blooming landscape" in a very short time[12], and prepare measures to ensure they do not fall disproportionately on the most vulnerable sections of the population.

C. Regaining policy space: Lessons from the Marshall Plan

Faced with complex and apparently intractable problems or with the consequences of major disasters, politicians, particularly those in Western Europe, have increasingly called for a "Marshall Plan" as part of the response. The UN's Economic Commission for Europe (UNECE) seems to have started the fashion in early 1990 when it argued the need for a programme on the scale of the Marshall Plan to assist the countries of Eastern Europe in their transition from centrally planned to market economies (UNECE, 1990). This was taken up by German Chancellor Helmut Kohl and his Foreign Minister, Hans-Dietrich Genscher, who called for a Marshall Plan for Russia in 1992. In 1997 the then European Commission President, Jacques Santer, described the programme and costs of EU enlargement as "a veritable Marshall Plan" for Eastern Europe. In April 1999 British Prime Minister Tony Blair called for a "Marshall Plan" for the Balkans[13] and in October 2001 the Italian Prime Minister, Silvio

[12] This was Chancellor Helmut Kohl's promise to the population of the former German Democratic Republic in 1990.

[13] Blair's proposal for a Balkans Marshall Plan seems to have alarmed his own officials – "We have never used that phrase" was the lofty comment from a Foreign and Commonwealth Office spokesman. In February 2002, at the World Economic Forum in New York, a somewhat bitter Zoran Djindjic, the reformist Prime Minister of post-Milosevic Serbia, was warning Afghanistan not to count on western promises of aid to support post-war reconstruction and reform.

Berlusconi, proposed one for solving the economic problems of the Palestinians on the West Bank[14]. None of this rhetoric came to very much, partly because finance ministers in the rich countries in the 1990s were grappling with fiscal deficits, many of them trying to meet the Maastricht criteria for entry into the European Monetary Union, and the last thing they wanted to hear were proposals for large increases in aid budgets. Moreover, the resurgence of neo-liberal ideas from the early 1980s meant the developed world was more in favour of free markets and foreign private investment than official aid or planning as the remedy for the problems of transition and under-development.

The terrorist attacks in the United States on 11 September 2001, however, led to rather more urgent calls, at least in Europe, for action on the scale of the Marshall Plan to deal with the problems of under-development. Within a few weeks, Mr Blair was citing the North-South divide between rich and poor as a fundamental factor in the growth of terrorism and in December 2001 British Chancellor of the Exchequer Gordon Brown proposed a "New Marshall Plan" which would double the aid provided by the rich countries to the poor ones. Both Blair and Brown stressed the security objectives of such an initiative. Three years later, on 17 December 2004, Brown, speaking in New York, continued to stress the tensions between the rich and the poor and argued that if the west failed to open its markets to developing countries, forgive debt and provide more generous aid, there was a real risk of "permanent guerrilla war fought not by conventional armies or nation states but by cliques and factions". Having implicitly condemned the idea that the "war against terror" can be won by the military, he declared: "We need to make an offer as bold as the offer that was made in the Marshall Plan of the 1940s." The links between terrorism and under-development, including grinding pov-

[14] The appeal of the Marshall Plan has not been confined to statesmen with their eyes on global issues: in June 2002, the Mayor of Toulouse declared "*un plan Marshall*" was needed to deal with the aftermath of the explosion at the AZF fertiliser factory in his city; and, soon after, Richard Rogers, the architect, was proposing a "a sort of regeneration Marshall Plan for public building in the UK – a massive infusion of planning, design and engineering skills". One suspects that the "Marshall Plan" has become a somewhat empty metaphor for any major or exceptional effort judged to be necessary to deal with particularly difficult situations.

erty and mass unemployment among young males with few or no prospects, are invoked more often by politicians in Europe than in the United States although US Secretary of State Colin Powell, during his post-tsunami visit to Indonesia in early 2005, stressed the need for cooperation to dry up "the pools of dissatisfaction" that led to terrorism. Prime Minister Blair and Chancellor Brown again called for a "Marshall Plan approach" in the run-up to the G8 summit in Scotland in 2005. It is never clear, however, whether those proposing "new Marshall Plans" see them as anything much more than a goodwill financial gesture to countries in need, and indeed there are many critics who dismiss such ideas on the ground that such large sums cannot be absorbed efficiently by the receiving countries and that they are likely to fall into the hands of corrupt politicians and government officials.[15] The Marshall Plan, however, was much more than just a financial package and it is far from clear that those attached to neoliberalism and the idea of the irresistibility of market forces will be keen to embrace its other features.

The Marshall Plan of 1947 was certainly generous, providing Western Europe with some $12.4 billion over a four-year period, most of it in the form of grants rather than loans. The programme amounted to just over 1 per cent of the US's GDP and over 2 per cent of the recipients'. The Marshall Plan did much more, however, than supply Europe with lots of dollars; it also introduced a framework of organising principles intended to ensure that the aid was used effectively and to encourage policy makers to forge a new kind of "social contract" that would be radically different from the deflationary and divisive actions of the inter-war period (Mazower, 1998:299). These aspects of the Marshall Plan are almost entirely absent from current suggestions for a "new" version, but it is precisely here that useful lessons can be drawn for development policy.

It is also relevant, in light of the experience with adjustment programmes, to recall that the Marshall Plan was actually a belated recognition of the fact that policy makers in the United States, especially in the US Treasury, had been far too optimistic about the time it

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15 For a cross-section of opinion on the current state of the aid debate see IDS (2005). On two sharply differing views on the aid and planning debate, see Easterly (2006) and Sen (2006).

would take to return to "normality" after the cessation of hostilities. By this was meant a return to a system of multilateral free trade and payments, in accordance with the rules of the new Bretton Woods institutions which were to provide the basic architecture of the post-war economic system. The attempt to put these new arrangements into place rapidly, an early example of "shock therapy", had foundered in a series of European dollar crises and particularly the sterling convertibility fiasco of 1947. Large amounts of relief assistance had been pouring into Europe before 1947 and members of the United States Congress were complaining about their taxpayers' dollars disappearing down a European "rat-hole", a story with a familiar ring today.

When the United States Secretary of State George Marshall made his famous speech at Harvard in June 1947, the economic and political outlook for Europe was far from encouraging. The post-war recovery in output appeared to have stalled and there were fears of rising social unrest and of communist parties winning elections in several countries. Marshall was explicit that the economic dimension of security was uppermost in his mind[16]: "Our policy is directed against hunger, poverty, desperation and chaos … so as to permit the emergence of political and social conditions in which free institutions can exist." Marshall would thus have agreed with Chancellor Gordon Brown in seeing poverty, not a hatred of freedom, as an incubator of terrorism. It is also notable that Marshall saw free institutions emerging from "economic health", not the other way round. When critics object to proposals for "new" Marshall Plans for certain countries on the grounds that they are not democracies or do not possess market economies, they forget that Marshall Aid was not so demanding: Italy and West Germany adopted democratic institutions only in 1948 and 1949, and in Italy many of their provisions were ignored as part of the strategy to keep the communists out of power. Although most of the institutions of a market economy did not have to be built from scratch, the various European economies had been highly regulated and subject to direct controls for the best part of a decade, and with large sections of the population still suffering considerable privations, quick

[16] The text of Secretary Marshall's speech, from which this and the following quotations are taken, is published in OECD (1978:227-29).

fixes and shock therapy for a return to "normal" market conditions were considered neither economically feasible nor politically acceptable. Once again there is a sharp contrast between the policies rich countries adopted for themselves and those they consider appropriate for others. It is true that the Marshall Plan was ultimately directed at keeping the Soviet Union out of Western Europe and communist parties out of West European governments, and the US administration may not have been too particular about the democratic credentials of some of the recipients of aid. But it would anyway have been unwise to have set stringent democratic preconditions for receiving economic assistance. If the lack of assistance were to have made the economic situation worse, the outlook for developing democratic institutions would also have been likely to deteriorate.

With this background in mind, there are at least seven major virtues of the Marshall Plan which provide useful lessons for rebalancing the policy environment facing developing countries today. *First*, it set a time frame for the post-war adjustment process that was more realistic than that envisaged by the US Treasury or by an IMF programme. Instead of thinking in terms of 18 months, the time scale was changed to four to five years. *Second*, Marshall made it clear that there was to be an end to the piecemeal assistance which had suffered from a lack of coordination and had less impact than expected in stimulating economic recovery. A key requirement, therefore, was that each state recipient of aid had to produce a four-year outline plan for recovery, setting out targets for the main economic variables and providing an account of how the government intended to achieve its objectives. *Third*, Marshall insisted that these plans, together with estimates of the need for assistance, had to be drawn up by the West Europeans themselves: "It would be neither fitting nor efficacious for [the United States] to undertake to draw up unilaterally a program designed to place Europe on its feet economically. This is the business of Europeans … The role of this country should consist of friendly aid in the drafting of a European program and of later support of such a program …" Marshall thus acknowledged national sensibilities, admitted that the recipient countries were better informed about the facts of their situation than outsiders, and generally showed a deference towards European traditions and preferences that has been conspicuously absent in the subsequent attitudes of the rich countries and international institutions towards the rest of the world.

A *fourth* feature of the Marshall Plan was that aid was released in tranches that depended on the countries' intermediate targets being met. The removal of the recovery programme from the Bretton Woods framework did not therefore imply an escape from conditionality, but the Marshall Plan conditions were different, more flexible and were to be met over a longer period than allowed by IMF rules. Conditionality was important not simply to ensure that the aid was being used effectively but also to gain, and sustain, the support of the American taxpayer.[17]

Fifth, the Marshall Plan acknowledged that the damage to European productive capacities and the great disparity in economic strength between the United States and Europe meant that rapid liberalisation of trade and payments would quickly lead to European payments crises. It was accepted that Europe would gradually dismantle a wide range of direct and indirect controls on its trade according to an agreed timetable within the framework of the European Payments Union between 1950 and 1958. This gradual liberalisation of trade provided European producers with protection against American competition and gave them time and encouragement for the reconstruction of enterprises capable of producing competitive substitutes for dollar imports. At the same time, the US agreed to a more rapid improvement in access to its own market for European exports, a policy of asymmetric liberalisation that stands in marked contrast to the present approach of the EU and the United States which insists on a rapid opening of developing countries' markets and on restricting the range of policy options available for their development. Another, largely forgotten aspect of American restraint towards the relative economic weakness of Europe in 1947 was a moratorium on foreign investment in Germany until monetary equilibrium had been more or less achieved (Kindleberger, 1989). The prospect of US capitalists buying up Mercedes, Siemens and other major companies at derisory

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[17] This in turn was needed in order to strengthen the hand of the State Department and the Marshall Planners in overcoming the opposition of Senator Taft and his Republican supporters in Congress who were against not only the Marshall Plan but also the United Nations and anything else that smacked of multilateralism.

prices did not appear to the State Department as a useful contribution to winning the "hearts and minds" of a defeated population and a future ally.[18]

Sixth, effective leadership requires generosity. Marshall Aid consisted largely of grants and the small proportion of loans contained a large element of grant: they were usually for 35 years at 2.5 per cent interest with repayments starting in 1953. It is worth emphasising this structure of financial help at a time when "aid" and "assistance" are used loosely to cover everything from gifts to loans at market (or above-market) rates of interest. The wisdom of adding to the debts of already heavily indebted economies is highly questionable, the more so when they are grappling with economic restructuring and institution-building, which is typically the case for countries trying to accelerate their development or to recover from the chaos that normally follows the end of violent conflict. A generous supply of grants, monitored within and conditional on a coherent economic programme on the lines of the Marshall Plan, can be more effective than loans in lifting countries out of a "stagnation trap" where heavy debt-servicing obligations hold back the domestic and foreign investment that could improve the longer-run performance of the economy, including its capacity to service debt. Another advantage of grants is that they are not usually subject to the long and complex negotiations, legal and financial, associated with loans. This is important because one of the lessons of the Marshall Plan is that prompt assistance at the start of a promised programme can help to sustain positive expectations, which most likely will have been raised by politicians, and instigate a momentum for change that will stand a chance of becoming self-reinforcing. Aid is usually provided with a close eye on the interests of the donor, to strengthen a bilateral alliance, secure supplies of raw materials, boost exports and so forth. That is to be expected, but a lot depends on whether donors see their interests narrowly or broadly, short-term or long-term, and whether larger public interests prevail

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[18] For economists involved in the Marshall Plan, such as Charles Kindleberger, this was a sensible policy based on the theory of second best, namely, that when markets fail to work, or do not exist, they should not be used. Instead, the priority should be to create or rebuild the institutional framework that will ensure they do work efficiently. Even in one of the most advanced economies of the day, that was expected to take some time.

over narrower corporate ones. There are public-goods aspects to aid if it succeeds in raising the prospects for growth and development and thereby reducing threats to regional and global security, easing the pressures for migration, and so on. Grants may therefore generate a higher rate of return in terms of the donors' larger interests than loans.[19] Marshall Aid grants were arriving in Europe in well under a year from General Marshall's speech in June 1947, a painful contrast with the assistance efforts of the G7 over the last few decades which have been dominated by loans and characterised by large discrepancies between pledges and deliveries, long delays in disbursement, and weak coordination among a large number of donors with often competing interests.

Finally, the *seventh* virtue of the Marshall Plan that we consider relevant to current problems was its insistence that there should be a degree of united and cooperative effort among the Europeans themselves, and that the plans of the 16 recipient countries and the allocation of aid should be coordinated in a regional body.[20] This requirement partly reflected US foreign-policy objectives for a more integrated Europe, but it provided a structure for cooperation in areas where there are significant externalities, economies of scale and other trans-boundary issues. The peer review of national programmes provided national policy makers with a regional perspective for their own policies and encouraged a culture of regular contact and cooperation among national bureaucracies which today is taken for granted in Europe.

Regional bodies are now frequently opposed by the G7 countries, which tend to prefer global institutions where they can assert more control over decisions.[21] That of course is one reason in favour of them from the standpoint of countries in a region, an advantage that many members of the EU often stress. But for most countries, most of the time, many of their pressing everyday problems involve their neighbours. Regional cooperation to lower trade barriers and other obstacles to doing business within the region can provide larger

[19] Economists will no doubt raise the "free rider" problem but that should be irrelevant to these broader, strategic interests of the G7 countries.
[20] This was the Organisation for European Economic Cooperation, founded in April 1948, and which was later converted into the OECD.
[21] Concerns about regional trade agreements are discussed in the next section.

markets for small, low-income countries and make it easier for them, if it suits their development strategies, to attract FDI.[22] For small, fragmented economies infant-industry policies may be more effective in a regional than a small national market. Regional cooperation can also make it easier to deal with black markets, organised crime and other activities which have the power to undermine democratic and market institutions. The very fact of increased efforts at such cooperation is itself a sign of increasing stability and security in a region and that can be an important influence on economic activity in general and fixed investment in particular.

One of the important aspects of post-war regional cooperation in Europe, in institutions such as the OECD, the UNECE and the EU, is that it encouraged a focus on "nuts and bolts" cooperation in resolving possibly mundane but nevertheless important practical problems, such as trade facilitation, harmonising standards for various traded products, trans-boundary air and water pollution, and so on, where all the parties can see that they will gain from agreed rules or norms and therefore have an incentive to cooperate.[23] The practical consequence, however, is the gradual evolution of a form of regional or international governance as countries seek ways to reconcile their pursuit of national objectives with international constraints, an activity based on local knowledge that can also contribute to developing the autonomous learning capabilities that we identified earlier as crucial for promoting both development and democracy. This suggests that the necessity and benefits of collective action, on the one hand, and the evident desire of peoples to preserve as far as possible their autonomy to decide national policy, on the other, can be balanced in many areas without the need for overarching global bodies.

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22 As we have suggested in the case of Mexico, the regional option should not be seen as a panacea.

23 The UNECE, for example, with the most comprehensive membership of the European region, brought together countries that were bitterly divided over political and social values, and yet they succeeded in reaching agreement on a range of practical issues. "The UNECE's experience shows that cooperation can move ahead by accepting certain differences in preferences and values. This does not imply accepting murderous behaviour and violations of human rights, but it does imply recognition that there are differences and preferences that may not be reconcilable and should therefore be accepted and recognised by others" (Berthelot and Rayment, 2004:130).

What we are suggesting is that the *processes* of the Marshall Plan can help to provide a coherent framework for coordinating national economic-development plans with international assistance. Without an articulate account of a government's macroeconomic objectives and their relation to detailed programmes for infrastructure investment, education, health, housing, etc., it is difficult to see how limited supplies of foreign assistance, financial and technical, can be really effective. Official assistance is essentially a form of intervention to ease shortages, bottlenecks and other constraints on growth and structural change, but it is difficult to target aid to where it will be most effective without some idea of priorities and the potential marginal effect of removing one bottleneck, say, before another. Similarly, the impact of assistance will be reduced if complementarities are overlooked: the value of funds for treating the victims of HIV/AIDS and other major diseases, for example, will be diminished if the planning and funding of health support services is neglected or underestimated.

Despite the demonstrated success of the Marshall Plan framework in Europe in the 1940s, "aid" has developed over the years into a mixture of assistance for an assortment of specific projects and ad hoc responses to unexpected shocks with little apparent coherence, either in the countries that receive it or in its global distribution. Donor conferences are more like bazaars, driven more by what donors want to promote than by the desire to support specific multi-year, national programmes. It is difficult to see how aid can ever be really effective without an articulation of macroeconomic objectives and detailed programmes for infrastructure investment etc., and without a coherent account of priorities – what should be done in what order – and a sense of the necessary complementarities among different investments and projects.

National development programmes along the lines of the Marshall Plan would also make it easier to provide general, non-project assistance to government budgets or the balance of payments, as was done for a number of European countries under Marshall Aid. Development (even more than reconstruction) programmes essentially deal with deep-rooted structural problems and both fiscal and current-account deficits are usually unavoidable if constructive, long-run adjustment is to be achieved. The need to provide financial assistance to deal with long-term imbalances is usually seen by the international financial institutions as evidence of a weak commitment to reform and as encouraging a slackening of discipline by postponing necessary adjustment. This was not the view of the Marshall Planners, who regarded such assistance as an investment in structural change and as providing governments with the breathing space required to bring difficult and often painful policies to success. When such policies threatened to cause social upheaval on a scale that might upset the adjustment process, as was the case in post-war Italy at one point, Marshall Aid was available to support the government budget in order to cushion the social costs.

Another major attraction of a Marshall Plan framework is that it can serve an important political function. A multi-year programme of economic and social objectives, setting out their interrelationships, the means to achieve them and their contingency on outside assistance, effectively sets out the government's vision of the structure of society at which it is aiming. That is highly political, and so the proposed programme provides a basis for the democratic discussion and the negotiation between competing views that should take place. This is not an easy task, as the history of French indicative planning shows (Cohen, 1977), but obtaining popular support for such a programme can be a major stimulus for change. This will not always result in what the international financial institutions regard as the "best" policies, but the advantage of democratic processes, as we suggested in the previous chapter, is that they generate pressures to correct mistakes: they may reach the "best" policy more slowly than if driven by autocratic outsiders, but politically the slow route may be superior. A "new Marshall Plan" could thus be a way to provide a concrete operational basis for such ideas as "ownership" and "partnership", which otherwise risk degenerating into empty slogans. Moreover, a coherent national programme with popular support, indicating where outside assistance could be most effective, *ipso facto* becomes a powerful argument for persuading potential donors to respond to national priorities rather than following their own preferences from a basket of seemingly unrelated projects. The emphasis on *national* programmes is deliberate because the problem with recent suggestions for a new Marshall Plan for Africa, for example, is that they seem to imply that the continent is homogeneous, which is very far from being the case. The approach in Europe in the late 1940s was to treat each country as a specific case but to bring them together in a regional framework of cooperation that would support both national objectives and regional coherence.

D. Strengthening the profit-investment-export nexus

We have insisted throughout this book that the task of moving from strategic development goals to specific policy measures can only be done through experimenting, arguing and bargaining at the national level where "local heresies" will be decisive (Rodrik, 2003:13), an approach that, despite the differences in the nature and the magnitude of the challenges facing Western European reconstruction, was very much followed by the Marshall Planners. We have also insisted that in a non-linear, non-equilibrium and multi-dimensional economic world, institutions and policies cannot be taken as given or static but must evolve over time as development proceeds. By implication the functions and activities of the state will also change as industrialisation proceeds and institutional development deepens.

In trying to move the discussion of development strategies forward, it seems to us useful to draw from our comparative analysis of the trends in capital formation, export performance, industrialisation and growth a more disaggregated classification of where developing countries stand in relation to one another after a quarter of a century in which the pendulum has swung strongly towards international firms and market forces:

- *Mature industrialisers*: This group includes the first-tier NIEs, notably the Republic of Korea and Taiwan Province of China, which achieved industrial maturity through rapid and sustained accumulation of capital, growth in industrial employment, productivity and output, as well as manufactured exports. In the 1990s these economies enjoyed a share of industrial output in GDP above the levels of advanced countries, exports had shifted to more capital- and technology-intensive goods, and industrial growth was starting to slow down as resources shifted towards the service sector.