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ECONOMIC DEVELOPMENT CENTER



**THE FUTURE OF U.S. FOREIGN
ECONOMIC ASSISTANCE**

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The Future of U.S. Foreign Economic Assistance*

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The Future of U.S. Foreign Economic Assistance

When the Bush administration assumed office in 1989 the United States development assistance program was in disarray. The bilateral development assistance component of the assistance budget had declined from \$3.5 billion (in 1989 dollars) in the last Carter budget to \$2.8 billion in the last Reagan budget - a decline of 20 percent. The supporting (ie. security) assistance component which had experienced rapid growth in the first Reagan administration declined continuously during the second Reagan administration. During the winter of 1991 both the administration and the Congress developed plans to review the U.S. assistance effort. In this paper I attempt to chart several alternative scenarios for the future of U.S. foreign economic assistance. Before doing so, however, it will be useful to first step back and review the forces that have shaped U.S. assistance policy in the past.

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U.S. development assistance policy, following the post World War II relief and recovery efforts in Western Europe and East Asia, has been guided by a series of four successive strategic visions:¹

The first was outlined as the fourth point in President Harry S. Truman's inaugural address of January 20, 1949. In that speech, Truman proposed "a bold new program for making the benefits of scientific advances and industrial progress available for the improvement and growth of underdeveloped areas." This was the technical assistance vision.

The second was the vision articulated by John F. Kennedy in his presidential campaign and in his first years in office that "a more prosperous world would also be a more secure world." This articulation held out the promise of refocusing the security concerns of the Eisenhower administration from containment to development. The assistance policy that emerged emphasized the transfer of large financial resources by both bilateral and multilateral institutions.

The third was the vision articulated by members of the House Foreign Affairs Committee in the late 1960s and early 1970s - a "New Direction" in foreign assistance that would focus on basic human rights and human needs. Aid should be directed to the political empowerment and the improvement of the economic well being of the poorest people in the poorest countries.

The fourth was closer linkage of economic and security assistance and the doctrine of "privatization" emphasized in the rhetoric of the early Reagan administration. The privatization issue was not a new theme in U.S. development assistance policy. It was foreshadowed by the "trade-not-aid" rhetoric of the early Eisenhower administration.² Translation of the Reagan administration rhetoric into policy was confronted by an AID administration whose emotional commitments were closer to the New Direction themes than to the agenda of the right wing of his own administration. In addition, the leadership of the AID Private Enterprise Bureau was inept in its efforts to link doctrine to policy and program. The Bush administration, with its focus on "democratization and privatization" appears to be more effective in pursuing the Reagan agenda.

Throughout the four decades between the late 1940s and the late 1980s, there have been two overarching constraints on the pursuit of the four visions or strategies.

The first is that United States development assistance policy has largely been derivative of cold war containment strategy. The growth and decline in the magnitude of assistance flows have been dominated by the intensity of the cold war. The decline in support for economic assistance since the mid-1980s is only the most recent manifestation of this relationship. When the effectiveness in the use of aid resources for development purposes has appeared to be in conflict with short run strategic objectives the strategic objectives have generally dominated assistance policy. As the intensity of the cold war has declined domestic ethnic politics have played an increasingly important role in the geographic flow of assistance resources.

The second is the continuing gap between the articulated objectives of assistance policy and the limited resources that have been made available to realize these objectives. The commitment to global poverty reduction in the 1970s and debt restructuring in the 1980s are among the more recent examples of the gap between rhetoric and resources. In fiscal 1990 budget authority for U.S. bilateral economic assistance, including both development and strategic assistance, amounted to less than \$6.0 billion.

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In spite of the constraints of doctrine and resources under which the U.S. assistance policy has labored, there are a number of important lessons from past experience.³ Let me turn first to some of the lessons from assistance for sector development and then to the lessons from macroeconomic assistance policy.

Sector Policy

Assistance to physical infrastructure development. During the 1950s and 1960s, large scale investment in transport facilities (roads, railroads, ports, airports) and multipurpose resource development projects (power, flood control, irrigation) occupied a very prominent place in both bilateral and multilateral development assistance portfolios. Many of these projects made substantial contributions to the development of recipient countries. Others became a burden. During the 1970s, infrastructure projects were severely criticized on technical grounds. Cost overruns were often substantial; the technology was often incompatible with the level of country development; failure to consider exchange rate distortions often led to inappropriate investments. During the 1970s, infrastructure investments became the subject of intense scrutiny and severe criticism by the environmental community. Some of this criticism was valid. Much of it was overblown. It is, however, again possible to take a much more positive view of lending for infrastructure development. The technical, environmental, and economic aspects of project evaluation and design have become more sophisticated. And the services provided by infrastructure are essential for economic growth.

Agricultural and rural development. Sustained growth in agricultural production requires a close articulation of public and private sector support for research, development and technology transfer. The private sector has generally been relatively efficient in the development and transfer of mechanical and chemical technology and in the distribution of technical inputs. The public sector has been more effective in the development of biological and information technology. Public sector agricultural research and extension has achieved

rates of return that are among the highest available to either national governments or development assistance agencies. The underinvestment in agricultural research reflects a continuing failure on the part of both donor agencies and national governments to understand the role of agricultural development in generating economic growth and in contributing to more equitable income distribution.

Efforts by bilateral and multilateral donors to assist in the development of integrated community and rural development progress have met with much less success than attempts to enhance agricultural production. One of the major sources of disillusionment has been the lack of consistency between the dynamics of rural development and the imperatives of donor assistance. Successful rural development programs tend to be small in geographic scope, and slow to implement; impose intensive demands on professional and administration capacity; difficult to assess within the framework of conventional cost benefit analysis; and difficult to monitor. A second source of disillusionment has been the difficulty of achieving congruence between the local-self help and resource mobilization philosophy of rural development programs and the objectives of donors to achieve measurable improvements on basic human needs indicators within the space of the project cycle.

Assistance for investment in human resource development. Both the development theorists and assistance agencies were slow to recognize that investment in education and other forms of human capital represented a high pay-off source of economic growth. As evidence began to accumulate, indicating high rates of return to education, perspectives began to change. Assistance in health and family planning also came to be recognized as an investment in human capital. The initial transfer of health technology from western

society to developing countries has often been inappropriate. We have transferred sickness recovery systems rather than health systems. There is an enormous challenge facing the development assistance community, as well as national health systems, to design systems that enable families to live healthy lives so that they do not have to enter the sickness recovery system. There is also an enormous need for the establishment of health research capacity in the tropics. A combination of malaria and tuberculosis resurgence, the high cost of dealing with infectious disease, the failure to make progress in dealing with parasitic disease, the emerging AIDS epidemic and the health effects of environmental change suggest that over the next two decades the health dimension of human resource development should command a level of attention similar to that received by agriculture in the 1960s and 1970s.

Macroeconomic Policy

The influence of domestic economic policy on the effectiveness of donor economic assistance. The effectiveness of economic assistance has been strongly conditioned by both the more economic and sectoral economic policies of the host country. The contrast between (a) the effectiveness of assistance to Korea before and after 1961 and (b) the effectiveness of assistance to Ghana and Ivory Coast during the 1960's and 1970's are among the more dramatic examples. In the early 1960s Korea was still regarded as an economic "basket case". The Syngman Rhee government managed economic policy to maximize foreign economic assistance rather than enhancing economic growth. It was only after more growth oriented policies were adopted in the mid-1960s that the physical and institutional infrastructure investments funded by U.S. economy assistance in the 1950s began to pay off.

At independence in 1957 Ghana had a well established export sector, a reasonably well developed physical infrastructure, a relatively high level of literacy and the highest per capita income in Africa. The Ivory Coast lagged behind Ghana in practically every indicator of development. By the mid-1980s the economic situation in the two countries was essentially reversed. Ghana has pursued policies of import substitution and direct state intervention in almost every area of economic activity. In the Ivory Coast government policy was directed toward guiding rather than controlling the private sector.

Policy dialogue and policy based lending. The effectiveness of economic assistance is influenced (a) by the degree of convergence in the views of the donor and recipient countries concerning the later economic policies and (b) by the importance of economic development objectives relative to other donor motivations in decisions concerning the volume and allocation of economic assistance.⁴ The dominance of donor strategic interests relative to commitment to economic policy reform has been demonstrated repeatedly in the case of Turkey. The willingness of the U.S. to support Turkish policy in trading off economic reform against short term strategic concerns contributed to the severity of the series of growth cycles experienced by the Turkish economy (1950-1958; 1959-1969; 1970-1979). For an even more extreme example one can turn to the history of U.S. economic assistance to Egypt.

The influence of the size of assistance flows on national economic growth. The impact of the size of development assistance flows on the rate of economic growth of recipient countries represents a continuing theoretical and empirical puzzle. The evidence to support a conclusion that differences in the level of development assistance have

accounted for major intercountry growth differences is not available. There is some evidence that rates of return to economic assistance by the OECD countries has been relatively high.⁵ There is evidence, though somewhat inconclusive, that in the absence of effective macroeconomic policy there is a negative relationship between the size of foreign aid transfers and the rate of economic growth. But the evidence to support a conclusion that differences in the level of development assistance has accounted for major differences in inter-country growth rates is not available.

What is the bottom line? What should we have learned from the past? At the risk of only slight overstatement, let me make two assertions.

The removal of distortions in monetary, fiscal, trade, commodity, and consumer policy does not produce development! Policy reform is, in some countries, a necessary condition for development. It can reduce the "X inefficiency"--the gap between the level of output that has already been achieved and the level of output that is potentially feasible. But the real sources of economic growth are investments in human and physical capital and in productivity enhancing technical and institutional change. These more fundamental investments must draw on resources -- financial, political, intellectual -- that are not readily mobilized in the short run. They do not generate immediate increments in economic growth. They often require a generation or more to mature. The failure to make investments needed to expand technical and institutional capacity in the 1970s is a major reason why the response to the policy reforms of the 1980s have often been so disappointing.

One way of summing up is to insist that advising "shock treatment" for countries with weak or missing market institutions or limited technical capacity - that they go "cold turkey" on policy reform - must be rejected as little more than self indulgent intellectual sloth. It reflects a lack of willingness to invest the intellectual energy necessary to understanding the economies and the societies for which reform prescriptions are being written.

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Now let me turn to the future of U.S. development assistance. I will lay out two scenarios. The first will be what I would like to see happen. The second will be what I expect to happen. Both scenarios will be conditioned by a search for a post cold war rationale for U.S. development assistance. Is there anything that can, or will, replace the cold war as a rationale for the mobilization of U.S. resources to assist in the development of poor countries? Both scenarios attempt to take into consideration the changes in the global economy over the last several decades and the changing role of the United States in the world economy and polity.

The evolution of the global economic system has dramatically altered the demands and opportunities for effective foreign economic assistance. Until the late 1960s the world operated under a fixed exchange rate regime. The transfer of resources from dollar surplus countries to deficit countries could be viewed as part of the cost of maintaining the institutional infrastructure of an increasingly liberal international economic order - at least until the "dollar surplus" was replaced by a "dollar glut". We now have lived with a flexible exchange rate system for more than two decades. An international capital market has been put in place that makes it possible for countries that pursue reasonably sound domestic

monetary and fiscal policies to borrow the financial resources they need. The rationale for concessional resource transfers, other than to the poorest countries, has largely disappeared. Indeed, large concessional transfers can, unless carefully managed, result in perverse distortions in the recipient countries exchange rate.

The position of the United States in the world economy has also changed. The United States is no longer as confident of its technical leadership as it was when President Truman announced the "Point Four Program." It is no longer as confident of its capacity to assist in the design of education and health systems as it was when economists first started conceptualizing the role of human capital in economic development. It is no longer as confident of its capacity to contribute to the solution of either domestic or global poverty as it was when President Johnson outlined his "New Society" programs. And our confidence in our ability to prescribe monetary and fiscal policy for others ought to be much weaker than it was a decade ago when the U.S. was the world's largest creditor nation rather than the largest debtor nation. This means that we need to reform our bilateral programs in an economic cooperation rather than assistance mode.

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These changes in the international and in the domestic economy imply a much different mission for the U.S. assistance agency than in the past. We need to reform our bilateral program to operate in an economic cooperation rather than an economic assistance mode. United States assistance efforts should focus very largely on the high pay-off areas of human capital development and of technical and institutional change. My own model for the future would be an Economic Cooperation Agency (ECA) with much of its economic

development and humanitarian assistance activity organized in two semi-autonomous institutes under the ECA umbrella.

An Institute for Scientific, Technical and Economic Cooperation.⁶ The ISTECEC mandate should be to enhance the two way exchange of knowledge and technology among all nations rather than simply technical assistance to poor countries. In today's world the United States has as much to learn as to give from strengthening technical and intellectual interchange. The ISTC mandate should be global. It should include the OECE, the formerly centrally planned economies and the less developed countries. Emphasis should be strongest in areas such as agriculture, health, population and environment. Program operations should be largely subcontracted to the sectoral departments such as Agriculture, Health Education and Welfare, Environmental Protection and the National Institute of Standards and Technology - in which the scientific and technical capacity to implement the ISTECEC program resides. The funding necessary to maintain capacity for the nations major research universities should be placed on a long-term institutional grant basis somewhat similar to that provided by the Hatch Act for domestic agricultural research.

An Institute for Private Voluntary Cooperation (IPVC).⁷ Humanitarian concerns for the poor in the poorest countries and for those displaced by international conflict and domestic repression will continue to represent a basic impulse for foreign assistance by a wide spectrum of the American public. Official assistance agencies do not have a strong record of performance in this area. The IPVC should be organized to fund programs by PVO's, cooperatives, and other agencies on a competitive bases. Too much of present funding has been treated as an entitlement. A major emphasis should be placed on

strengthening indigenous PVO's. Much of food aid, except that allocated for so called "market development", should be channeled through the IPVC. I hope, but am skeptical, that the PVO's will be able to become more effective in using food aid as an instrument of development than in the past.

The Public Foundations

In addition to the ISTEAC and IPVC, serious attention should be given to strengthening the publicly supported development foundations. These include The Asia Foundation, the Inter-American Development Foundation, and the African Development Foundation. The historical roots of the Asia Foundation were deeply embodied in cold war doctrine. During the last decade, however, it has emerged with substantial capacity to work on issues of democratization and privatization - items high on the foreign policy and foreign assistance agenda of the Bush administration. The Inter-American Foundation and the African Development Foundations are products of the "New Directions" and "Basic Needs" foreign assistance thrust of the 1970s. They have now emerged with substantial capacity to work directly with the poor and with the informal sectors in poor countries. A cautious expansion in support for the programs of these public foundations would seem warranted. My caution stems from concern that too rapid growth in support could outrun their capacity.

Security Assistance

I have not discussed in this section the significant component of the foreign economic assistance budget allocated as (strategic) supporting assistance. This component of the

foreign aid budget has declined more rapidly than economic assistance since the mid-1980s. It is particularly difficult to assess the future of the supporting assistance component of the foreign assistance budget at this time. Regardless of the resolution of the Gulf War, it is reasonable to anticipate a rather complete review and reevaluation of U.S. security and economic interests in the entire region between Guam and Gibraltar. It would not be at all surprising if the United States, frustrated by its attempts to achieve political stabilization in East Asia, would conclude that its economic and strategic interests in the region are much less significant than in the past. One effect of such an evaluation is likely to be a decline in the flow of assistance resources to countries in which our assistance has the character of "rent" for military base rights and to the largest assistance recipients in the region, particularly Egypt and Israel.

Multilateral Assistance

A fourth area that needs to be discussed is the future of U.S. support for multilateral institutions. The relationship between the United States and several of the United Nations specialized agencies remains troubled. The ascendancy of the State Department Bureau for International Organizations, relative to the sectoral departments, in the formulation of U.S. policy toward the UN specialized agencies combined with personal antagonisms between Bureau administrators and specialized agency director generals and growing arrears in U.S. budget contributions have resulted in a weakening of the U.S. role in several of the specialized agencies. In spite of this troubled history it would not be surprising to see the emergence of stronger U.S. support for the work of specialized agencies in the 1990s. The

role of the United Nations during the Persian-Gulf crisis has generated a more positive official and popular attitude in the U.S. toward the U.N. The easing of U.S.-USSR tensions will remove some of the ideological tensions that frequently spilled over into U.S. relationships with the specialized agencies. Multilateral assistance will be seen by the U.S. government as a cheaper, and less frustrating, approach to assisting the economical and politically least developed Third World countries than bilateral assistance.

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Now let me turn to what I expect to happen. I do not see anything on the horizon that will be as effective as the cold war has been in generating the political resources necessary to prevent a continuation of the decline of assistance resources that has been going on since the mid-1980s.

The capacity of the U.S. to sustain its international commitments is continuing to erode. The growth of the U.S. economy, measured in terms of either aggregate or per capita productivity, has been slow. The decline in the relative strength of the U.S. economy has weakened our capacity to play a hegemonic role in global economic and political affairs. I have (reluctantly) found myself in agreement with Jean Kirkpatrick, who insisted, in a recent article in Foreign Affairs, that the U.S. must reconcile itself to being "just a power".⁸ But the declining capacity of the U.S. economy to sustain a first class global posture in economic and security affairs cannot fully account for the constraints under which U.S. foreign assistance will be forced to operate in the 1990s. The effects of the irresponsible fiscal policies pursued since the early 1980s will not be readily resolved. The annual interest burden on the national debt is now approximating the annual cost of the military budget.

This means that, at least for the next decade, the U.S. government will be forced to tailor both its foreign and domestic policies to a very constipated fiscal environment.

Are there any forces at work which might reverse the anticipated decline in assistance resources? One could be the emergence of one or more common threats to the well being of both developed and developing countries. There has been a good deal of rhetoric recently about environmental security. There is little doubt that the transnational nature of a number of environmental threats - global climate change, acid rain, and others - will require the strengthening of transnational or international institutions. There is also the possibility of a global health crisis emerging as we move into the first decades of the next century. A global health crisis could result in an international resource mobilization effort to resolve the crisis. It is doubtful that the number of refugees moving across borders will decline. But I do not visualize any of these common concerns generating the political resources that will be needed to prevent the erosion of U.S. assistance resources.

I find myself particularly concerned about the process of assistance policy formation and resource allocation as we move into the post cold war era. Each assistance constituency, within the government and outside, is attempting to carve out for its favored program area (population, environment, food and others) a larger share of a declining assistance budget (Table 1). The lack of a central policy focus leaves the assistance budget particularly vulnerable to such efforts.

The continuing fatigue and disorientation in the U.S. bilateral effort will not be resolved by the typical Washington remedy - by reorganizing AID. Moving organizational boxes around (as in the 1979 reorganization that created IDCA); attempts to rationalize

interagency conflict and cooperation (as in the 1990 food aid reforms); or attempts to grant parts of the aid program greater autonomy from political pressures (as in the case of the public foundations such as The Asia Foundation or the Inter-American Development Foundation, or my suggestions in this paper) will not resolve this problem.

The problem of lack of focus will not be resolved until a new post cold war vision of the kind of world that we want to live in during the first half of the 21st century captures the political and popular imagination.

Table 1

DEVELOPMENT ASSISTANCE CONSTITUENCIES AND CONCERNS

<u>Economic Constituencies</u>	<u>Donor Oriented Political and Strategic</u>	<u>Recipient Oriented Economic Development and Humanitarian</u>
White House and State Department	++	0
Office of Management and Budget	0	0
Treasury Department	0	+
Agency for International Development	- 0	++
Congress		
• Idealist	0	++
• Realist	++	0
Foreign Policy Establishment		
• East-West wing	++	0
• North-South wing	++	+
Suppliers	0	++
Ethnic Communities	++	- +
Human Needs	--	++

++ = strong positive concern
 + = moderate positive concern
 0 = neutral
 - = moderate negative concern
 -- = strong negative concern

ENDNOTES

¹This section draws on a series of papers prepared in collaboration with several students: Joseph V. Kennedy and Vernon W. Ruttan, "A Reexamination of Professional and Popular Thought on Assistance for Economic Development: 1949-1952", Journal of Developing Areas 20 (April 1986), pp. 297-326; James M. Hagen, "Development Policy Under Eisenhower and Kennedy", the Journal of Developing Areas 23 (October, 1988), pp. 1-30; Rolf H. Sartorius and Vernon W. Ruttan, "The Sources of the Basic Human Needs Mandate", Journal of Developing Areas 23 (April 1989), pp. 331-362; Mark. M. McGuire and Vernon W. Ruttan, "Lost Directions: U.S. Foreign Assistance Policy Since New Directions", The Journal of Developing Areas 24 (January 1990), pp. 127-180.

²See Department of State, The Commission on Security and Economic Assistance, Report to the Secretary of State (Washington, DC: GPO, 1983) (The Carlucci Commission Report).

³This section draws on material discussed in greater detail in Anne O. Krueger, Constantine Michalopoulos and Vernon W. Ruttan, Aid and Development (Baltimore: The Johns Hopkins University Press, 1989).

⁴For more extensive discussion the reader is referred to the very useful reports on the effects of adjustment lending prepared by the World Bank. See particularly: (a) International Bank for Reconstruction and Development, Country Economics Department, Report on Adjustment Lending (Washington, DC: August 1, 1988) and; (b) International Bank for Reconstruction and Development, Country Economics Department, Adjustment Lending Policies for Sustainable Growth (Washington, DC: Policy and Research Series #14, 1990). For an earlier report on U.S. bilateral policy based lending experience see Agency for International Development, The Use of Program Loans to Influence Policy (Washington, DC: US/AID/DDC/Evaluation Paper 1A, March, 1970).

⁵Willis L. Peterson, "Rates of Return to Assistance Capital: An International Comparison," Kyklos 42 (Fasc.2); pp. 203-4.

⁶This proposal calls for a broader mandate than the proposals for an autonomous Institute for Scientific and Technical Cooperation (ISTC) that were discussed in the late 1970s. It is similar to the proposal that has emerged from a series of recent workshops on the future of technical assistance. See G. Edward Schuh, "A Proposal to Establish a National Institute for International, Scientific and Technological Collaboration for Sustainable Economic Development," Minneapolis, Hubert H. Humphrey Institute of Public Affairs, December 1990. If the capacity of AID to manage science and technology programs continues to erode it is possible that ISTC responsibility should be located in another agency such as the National Institute of Standards and Technology.

⁷A Center for Voluntary Cooperation in Development was included in the International Economic Cooperation Act (HR 2655) passed by the House of Representatives on June 29, 1989. Its establishment was advanced by the PVO community. See the testimony by the President of the American Council for Voluntary International Action (Inter-Action), Peter J. Davies "Statement," in U.S. Congress, House of Representatives, Select Committee on Hunger, Role of Private Voluntary Organizations and the U.S. Foreign Assistance Program: Hearings (Washington, DC: US/GPO, 1989), pp. 14-20, 122-136.

⁸Jeane J. Kirkpatrick, "Beyond the Cold War," Foreign Affairs 69 (1990), pp. 1-16.

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