Aid will not make poverty history - but it is worth trying

MARTIN WOLF

Will the meeting of the Group of Eight leading countries in Gleneagles succeed in making poverty history? Those who doubt it differ sharply in their reasons. One side insists that aid will be wasted; the other that it will be inadequate. Which then is right?

In the "right" corner are those who blame poor countries for their plight. Corruption, theft, waste, civil conflict and state failure are, they argue, the cause of sub-Saharan Africa's enduring poverty. Additional aid is, in this view, more like petrol on a fire than water on a plant.

In the "left" corner are those who blame the rich. They condemn inadequate aid, heavy debt burdens, adverse terms of trade, privatisation, trade liberalisation and exploitation by multinationals. Aid helps the plants grow, they suggest. What is needed is a great deal more.

I am closer to the "right" than to the "left". A 10-year stint at the World Bank persuaded me that the good intentions we see on display this week are in themselves worthless, that the right incentives will generate development and, above all, that bad government is the single most important cause of failure.

Yet I also learnt not to oversimplify. Development involves vastly more than leaving everything to markets. Moreover, the moral imperative remains. Hundreds of millions of people do, as Columbia University's Jeffrey Sachs insists, live desperate lives in disease-ridden, drought-prone, infrastructure-starved and often land-locked countries. We are duty-bound to help if we can.

The aim must be a package that puts the poorest countries on the path of sustained growth. The UK, now chairing the G8, hopes for an agreement to double aid flows and relieve 100 per cent of debt owed to multilateral institutions (World Bank, International Monetary Fund and African Development Bank) of countries that meet the "completion point" criteria of the heavily indebted poor countries (HIPC) initiative. There are 18 such countries already, with nine more to come soon.

Assume then that there will be a large increase in aid, if not the doubling called for by the Commission for Africa. Assume also that this will be used in support of the "big push" approach to development it outlines.* Will this work? Several recent papers cast substantial doubt.

The former World Bank economist, Bill Easterly, for example, argues that there is no compelling empirical evidence for the ideas of "take-offs" from "poverty traps" driven by "big push" investment programmes.** Yet these three ideas underpin recent proposals for doubling aid to Africa.

Similarly, a paper co-authored by Raghuram Rajan, chief economist of the IMF, asks why there is so little evidence that aid accelerates economic growth.*** One reason, it suggests, is that aid-financed expenditures raise the price of skilled labour, which is intensively used in many government programmes, and shift skilled labour from the private to the public sector. They also drastically reduce incentives to produce exports and import substitutes, which include agricultural products.

In this last respect, aid is similar to discoveries of oil. But this is not the only way this is true. As Paul Collier of Oxford university points out, natural resource wealth has dire effects on governance.**** In a country without resources, politicians are dependent on the money they can extract from the people. In a country with large income from resources, the people become dependent on the money they can entice from politicians. The management of natural resource wealth is intensive in good government, but good government is, alas, not what sub-Saharan Africa enjoys (see chart).

Unconditional long-term budget support from outside donors is potentially identical in its effects to such resource wealth. Happily, Prof Collier comes to the conclusion that aid is not oil, but only because governments cannot do what they like with it. They are held at least partially accountable for its use. The form of aid that is most like oil is in fact debt relief. Once debt has been written off, a government has an unconditional increase in resources available to it. Debt relief should therefore be given only to countries with good performance and tolerable political accountability.

> Those who doubt the efficacy of aid differ in their reasons. One side insists it will be wasted; the other that it will be inadequate

There is, in all, good reason to fear that large increases in aid will have adverse economic and political effects on recipients. Sub-Saharan Africa is already much the most generously aided continent per head (see chart). It is also a continent that has suffered massive capital flight. Indeed, estimates suggest that the capital held outside the continent exceeds its total debt. When an elite sells its countries short, donors must ask whether they should take the long position.

The soft heart says that the rich countries should help the people of this ravaged continent. The hard head says that they cannot be confident of being able to do so. The sensible balance between the two is to proceed with preconditions. First, experiments with the big push should be made in countries that have tolerable governments. Second, donors must insist on transparent and accountable public finances. Third, they should minimise the adverse consequences of aid on the structure of production by encouraging import liberalisation and an import-intensive pattern of spending. Fourth, they should devote a substantial part of the additional money to research, particularly on improved agricultural technologies and health. Fifth, they should give a part of the resources directly into the hands of citizens. Finally, they should promote an environment conducive to a productive private sector.

Provided the increase in aid does not overwhelm economies, and governments are pledged to sensible policies and accountable spending, it is well worth trying. But no programme of external assistance will make poverty history. That can be achieved by Africans alone.

*Our Common Interest, March 2005, www.commissionforafrica.org/
**Reliving the 50s: the Big Push, Poverty Traps and Takeoffs in Economic Development?, June 2005, william.easterly@nyu.edu
***What Undermines Aid's Impact on Growth, June 2005, www.imf.org
****Is Aid Oil?, June 2005 http://users.ox.ac.uk/~econpco/research/aid.htm

martin.wolf@ft.com