

Two sides of the aid debate and the way forward

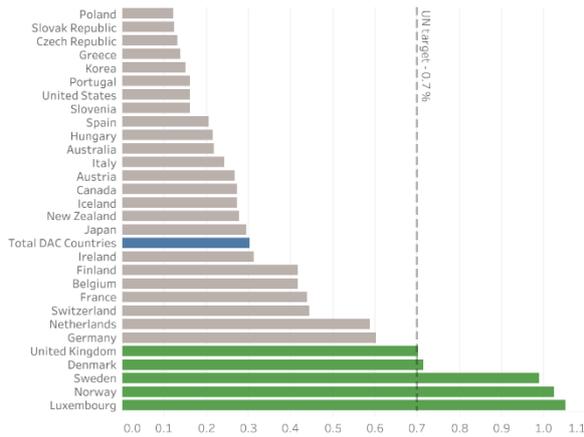
In 2019, the developed world sent almost 156 billion dollars on foreign aid to developing countries. However, the debate around aid is fierce. For some this is not enough to ignite development, for others it is a poison trapping these countries in poverty. What is the way forward?

Consensus in economics is hard to come by. Opposing views are intensely debated, each backed by their own set of evidence, hypotheses, and assumptions. In the end, this unsolved discussion is displayed in the uncertainty and hesitation around the best policy response available.

The field of Development Economics is not immune to this phenomenon. One of the most controversial subjects – as it involves trillions of dollars from developed countries and accountability – regards **the effectiveness of foreign aid**. In a broad sense, foreign aid encompasses all international transfers of capital, goods (food or supplies) or services (humanitarian aid or military assistance) either from a country or an international organization to another country. It can take the form of a gift, grant or loan and the most common type, which is at the centre of the discussion, is Official Development Assistance (ODA). The Marshall Plan, after World War II, is an economically successful and early example of US foreign aid which aimed to reconstruct Western Europe, that totalled 13 billion dollars (5% of US' GDP). After four years of the program, countries that were aid recipients registered economic growth that exceeded their pre-war levels. Nevertheless, the true impact of the Marshall Plan is still debated, with scholars questioning if the results were mostly due to the foreign aid granted or Europe's reconstruction efforts.

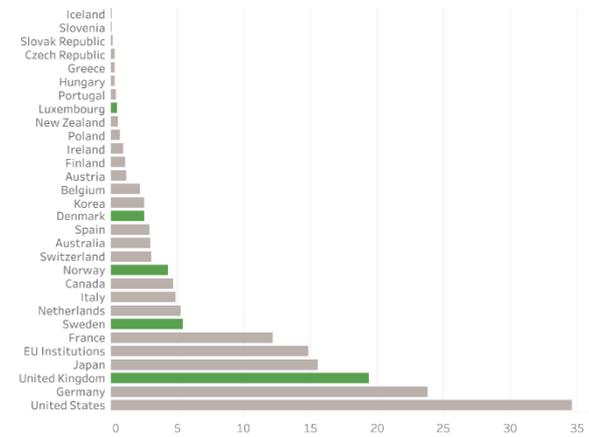
Aid has evolved since then and its importance is shown through the **commitment of developed countries of United Nations to pledge at least 0.7% of their Gross National Income (GNI) on foreign aid**. Despite this, currently, only 5 countries meet this condition, as Figure 1 shows (soon to be 4, given UK's 2020 aid budget cuts foreign aid to 0.5% of GNI). Since 1960, as seen in Figure 2, relative aid levels have plummeted from an average of 0.5% to 0.3% nowadays. However, the sum of foreign aid provided by members of the OECD Development Assistance Committee (DAC) has been steadily increasing – notwithstanding all global events in these seven decades: costly wars, economic downturns, globalization – reaching 155.6 billion dollars in 2019. In our current times, **these international transfers occur with the main goals of poverty eradication, debt relief and to aid sectors like health (fight of AIDS, Tuberculosis and Malaria) and education**.

ODA grant equivalent as percent of GNI (2019)



ODA on a grant equivalent measure by members of the OECD Development Assistance Committee (DAC) as percent of gross national income (GNI). Preliminary data for 2019.

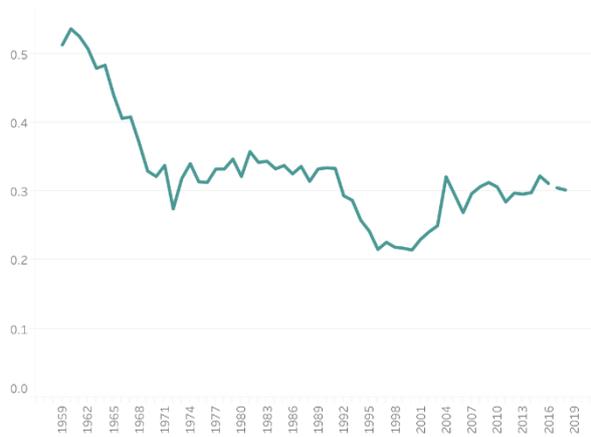
ODA grant equivalent - USD billion (2019)



ODA on a grant equivalent measure by members of the OECD Development Assistance Committee (DAC). Preliminary data for 2019.

Figure 1 - ODA (2019) % of GNI and total - OECD

ODA as percent of GNI



ODA on a grant equivalent measure by members of the OECD Development Assistance Committee (DAC) as percent of gross national income (GNI). Preliminary data for 2019.

ODA - USD billion (2018 prices & exchange rates)



ODA on a grant equivalent measure by members of the OECD Development Assistance Committee (DAC). Preliminary data for 2019.

Figure 2 - DAC ODA (1960 - 2019) % of GNI and total - OECD

Setting aside considerations over the necessary amounts, foreign aid is clearly present in the current foreign policy of developed countries and defined global goals. However, as hinted, its efficiency is not agreed upon, splitting the field of development economics into aid-enthusiasts and aid-sceptics. Nevertheless, there is one thing that both sides of the “aid debate spectrum” agree on: **Development means convergence with the West through economic growth, which alleviates poverty. This will occur through markets combined with the right incentives.** However, aid and technical assistance¹ may be considered to play a side role or to be a hindrance.

One of the most vocal pro-aid economists is **Jeffrey D. Sachs**. In his career as an economic advisor to governments around the world, Sachs has advocated for debt

¹ Non-financial assistance provided by local or international specialists

forgiveness and argues that debt servicing, for impoverished countries, contributes mostly to further lower living standards and political destabilization. In his most famous book, *End of Poverty* (2005), Sachs lays a roadmap to a prosperous world by 2025 – in which one of the central keys is foreign aid.

Sachs defends aid as a requirement to development through the concept of poverty trap. With extreme poverty (less than \$1.90 a day²), savings are non-existent and thus, day after day, capital³ accumulation depreciates instead of increasing. Therefore, if income is not above a certain level, the household finds itself in a poverty trap (Figure 3). Accordingly, it is not a consequence of lack of effort from the poor, but because it is impossible to “escape from extreme material deprivation” (page 19). The author elucidates with a simple example: if a household suffers from malaria or AIDS, even though efficient treatments are available, they are not able to purchase them and thus make this essential investment. Instead, they will get sicker which further decreases their income – a poverty trap set by the disease.

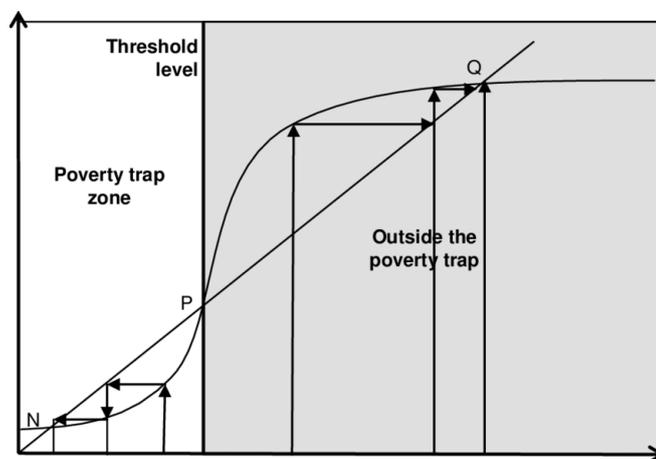


Figure 3 - Poverty Trap

Likewise, from a macro perspective, Sachs defends that these countries with extreme poverty are unable to reach the “ladder of economic development”, which the rest of the world is climbing. **Foreign aid would get poor countries on “the first rung”, pulling themselves into the global market economy, so they can start ascending on their own.** Furthermore, Sachs argues that foreign aid is not only beneficial for the developing countries but of the utmost interest to the donor countries. Sachs explicitly relates persistent poverty with many global maladies as war, state failure and terrorism. He proclaims that prosperity can only thrive by addressing the root cause of these problems: poverty.

Academic research has not identified any real effects linked uniquely to foreign aid, neither in the form of increased investment/economic growth nor in the improvement of human development indicators. So, given that foreign aid currently exists, why can't we observe significant and fast results to prove its efficiency? For Sachs this is not a proof of aid inefficacy. In fact, he states that this is due to a deficient amount of aid, given that the yearly

² 2011 prices.

³ Human capital, business capital, infrastructure, natural capital, public institutional capital and knowledge capital.

amount of **aid per capita in sub-Saharan Africa was only \$30 in 2002**, of which just \$12 went to Africa (the rest was for external consultants, food and emergency aid, debt servicing and relief), and thus not nearly enough to lift households out of poverty (estimated to be \$113 per person, totalling 0.6% of donor income yearly). Sachs concludes that ending poverty in a sustainable way is well within the means of the developed world, it is just a matter of wanting it.

Many disagree with Sachs on this matter. Some even argue that aid is slowing countries' development paths. Two aid sceptic economists are **Thomas Dichter and William Easterly**. Their main argument is that humans are naturally self-interested and profit-driven, which means that incentives only work when they involve both 'carrot and stick' in the right way.

As such, Dichter's overall conclusions state that **aid should be limited to emergency and refugee assistance and maybe some limited technical assistance on the (neoliberal) issues of good governance and property rights**. Otherwise, it will only fuel these countries' drives for corruption as well as inequality and poverty further on.

Easterly's work showed extensive evidence that **42 years of aid plans have not ended poverty**. The countries with the highest average aid over this period have seen a mere 0.4% growth in income. Besides, he criticized Structural Adjustment Loans (SALs)⁴ heavily. Fifteen African countries received an average of 24 SALs each and their average rate of income per capita growth has been negative: -0.4% per year (Easterly, 2006). Accordingly, Easterly claims that lending for structural adjustment should be discontinued, and utopian large-scale plans should be abandoned. Alternatively, **donors need to develop a way of working that includes feedback, accountability, independent evaluation of aid, incentives, and cooperation with small scale initiatives**.

Another aid-sceptic is economist **Dambisa Moyo**. Not only does she question the effectiveness of aid in combating poverty and inequality, but she also argues that aid is in fact highly detrimental to developing countries' economies. In her book *Dead Aid* (2009), **Moyo argues that official aid is easy money that fosters corruption and distorts economies, creating a culture of dependency and economic laziness**. She argues that aid has not merely failed to work but has compounded Africa's problems. As evidence, Moyo shows the exponential growth in poverty in an area of burgeoning aid, where 10% of Africans were living in poverty in the 1970s compared to 70%, 40 years later. In absolute terms, this means that roughly 600 million people were trapped in poverty in 2010 (Moyo, 2010).

Nevertheless, it is important to emphasize that in these former claims, humanitarian or emergency aid mobilized in response to calamities is not being included, nor charity-based aid given to specific organizations and people on the ground to achieve specific goals. Contrarily, Moyo addresses systemic aid, referring to vast sums transferred on a regular basis.

⁴ A structural adjustment comprises various economic reforms that a country must adhere in order to secure a loan from the International Monetary Fund and/or the World Bank. If such reforms are followed, the respective country can borrow Structural Adjustment Loans from such organizations.

As such, her harshest criticism is directed at aid from the governments of developed nations to African governments and aid from institutions such as the World Bank.

Nonetheless, there is still an aspect that is pivotal to take into consideration - **aid can and will only be effective in developing countries if combined with inclusive institutions pursuing good governance.**

Hence, there is great uncertainty around the aid debate with many lives depending on its outcome. However, in the last decade, **development economics has moved forward and focused on carefully analysing micro evidence** from small development interventions, keeping in mind that there cannot be a one-size-fits-all policy that is expected to solve every country's problems. Instead of looking at the big picture to see if foreign aid improves a country's conditions, the field is focusing more on analysing if specific programs are effective in certain regions. By opening the "black box of foreign aid" (Bourguignon and Sundberg, 2007), one can be more confident of the mechanisms of these micro interventions and their results. This experimental approach was distinguished in the 2019 economics Nobel Prize and it is the method that the NOVAFRICA Knowledge Centre uses on its projects.

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