

'Aid Effectiveness for Growth and Development'

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Introduction

Mr Brown's espousal of the desirability of increasing aid is to be welcomed. To realise this aspiration, donors must be convinced that the increased aid will promote growth and development. To justify a substantial increase in aid one should demonstrate that aid has and can be used effectively. The inherent difficulty in any attempt to assess how effective aid has been is that in practice a variety of aid instruments are used by many donors, for varying purposes and with different objectives that change over time (see Box 1). Aid can only be effective in achieving the objectives set by donors (ideally in partnership with recipients). Rather than attempt to cover the mixed evidence on the effectiveness of individual aid projects, we consider broad notions of effectiveness – economic and development.

Aid and economic growth

The conventional way to assess economic effectiveness is to ask if aid inflows on aggregate have been associated with an improvement in economic performance, and specifically in growth. On balance, the evidence suggests that the answer is yes. Contrary to what may have become popular opinion (Box 2), there is a positive association between aid receipts and subsequent growth performance. There is no simple recipe that identifies the policies that ensure growth.

Aid is only one of the factors that can contribute to growth, and rarely is it the most important. Many countries are poor and experience low growth precisely because they are especially vulnerable to economic (e.g. terms of trade) or natural shocks. Small tropical island economies, for example, are typically dependent on a narrow range of export commodities and vulnerable to devastation by hurricanes. Many African economies are similarly vulnerable to drought or floods. Many large countries, as in Africa or central Asia, are remote and face high costs in accessing markets, a major constraint on their economic performance. Aid can compensate for such problems, but cannot itself overcome them.

Mr O'Neil, US Secretary to the Treasury, responded to Mr Brown's proposal by observing that large amounts of aid have been given to Africa in recent decades without much evidence of a beneficial effect. He was implicitly observing that Africa has had a very poor economic growth record despite receiving large amounts of aid. However, many factors acting together contribute to the economic problems in Africa. Aid did not cause low growth in Africa (with some possible exceptions that are hopefully now in the past). Nevertheless, aid may not have been adequate to offset the constraints to growth. Partly this is due to failures in the way aid was delivered, and partly it reflects policy failures. Ultimately, however, it is because factors other than aid are the primary determinants of growth.

In economic terms, aid is beneficial in financing productive investment that contributes to growth. Roughly speaking, about one-third of global aid flows are directed at capital investment. While returns to investment are often low in developing countries, especially Africa (this is one reason why they are poor), the evidence shows that aid does support investment and this does contribute to growth. However, more than half of aid is not specifically intended

Box 1 Concepts of Aid Effectiveness

Effective means that aid has achieved an objective, and these vary.

- Only aid for investment should be evaluated against growth.
- Aid intended to benefit the poor is effective if the access of the poor to social services is improved.^a
- Specific aid projects should be evaluated against project objectives.
- Humanitarian aid may often be delivered inefficiently, but nevertheless alleviates hardship of the target populations.^b

^a More generally aid contributes to achieving development goals – see the *OPINIONS* on *Millenium Development Goals*

^b see the *OPINIONS* on *Chronic Political Emergencies*

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for investment. Aid is used to finance spending on the provision of health and education, or to finance debt relief (directly or indirectly), or is in the form of emergency relief or food aid. Such aid may not have an observable effect on growth, but may nevertheless be very beneficial.

Aid and development

A large amount of aid is intended to reduce poverty, or at least improve the welfare and living conditions of the poor, to provide public goods (such as health, education and protecting the environment) and even to support good governance. It is difficult to evaluate how effective such aid has been: many benefits are not easily measured and take a long time to materialise. Such aid can contribute to development (the welfare of people) even if it does not add to economic growth. This is one reason why we observe a significant improvement in social indicators in most developing countries since the 1960s. For example, life expectancy (a useful overall indicator) in developing countries increased from 46 years in 1960 (67% of the level in rich countries) to 65 in 1998 (85% of the level in rich countries). A similar pattern can be observed for infant mortality. Whilst achievements have been least in the poorest countries, there has still been progress and aid has been a contributory factor.

Targeted interventions, such as projects with a specific objective (e.g. to deliver vaccinations or build primary schools) or humanitarian/emergency relief, account for a substantial proportion of aid. These are not intended to contribute to investment, nor directly to growth, but can make a valuable contribution to development, and to the welfare of those who do benefit. One can always ask the question how might things have been without aid, even if there is no ready answer. It is easy to find anecdotes of aid being misused or siphoned off by corrupt officials. It is difficult to show, even in such circumstances, that the aid reduced growth or increased poverty. More importantly, lessons have been learned and the mechanisms exist to make aid more effective. Aid, or more generally a sustained donor-recipient relationship, has been instrumental in encouraging countries to adopt better policies. Aid leverage has helped to put the welfare of the poor on the policy agenda in recipient countries, as for example in Poverty Reduction Strategy Papers.

A Cautionary note

It is fair to say that aid has not achieved as much as might have been hoped by donors. Many countries are, in real terms, poorer now than they were in the 1960s. It is a moot point whether they would be any better off had they not received aid, but evidently aid has not benefited them much. Aid has often been misused and abused.

Box 2 Debunking myths about aid

- *'Aid is wasted money.'* Aid is not always effective, but most recent evidence shows that, in general, aid makes a positive contribution to economic performance. Countries do benefit from aid.
- *'Aid only works in a good policy environment.'* Although aid finance for investment is more productive in countries with good economic policies, aid can make a positive contribution even where policies are weak.
- *'Aid conditionality does not work.'* Whilst aid is an insufficient lever to force recalcitrant governments to implement reform, aid can play an important role in supporting and encouraging the reform process.
- *'Aid supports bad governments.'* One can certainly identify examples, but donors must have been complicit. It is now common for donors to suspend aid if government behaviour is unacceptable.

However, one should remember that there are two parties to an aid relationship, and in the absence of evidence to the contrary blame for failure can be equally apportioned. More importantly, aid is only one of many determinants of growth, and only one aspect of international economic and political relationships. Donor aspirations may have been excessive, especially if inclined to define effectiveness as measured increases in economic growth or reductions in income poverty.

In simple terms, aid has contributed to growth and development in low-income countries. It has made a very important contribution, but it is not a panacea. Evidence that aid has not been associated with higher growth rates in a country does not mean there should be less aid, it means there should be better aid.

Increase aid

The historic record of aid offers considerable promise that additional funds can be used effectively to promote growth and development. The past decade or so has witnessed promising signs of improvement in many aid recipients, evidence that aid can and does work. However, global problems, poverty and conflict are perhaps more prevalent now, so there are increased demands for aid. Increased aid is part of the solution to the challenge of development and poverty reduction. It is the part that donors can deliver, but many recipients have shown that they can deliver also.

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