

Is aid working?

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Introduction to Arena: is aid working

Commentary by Graciana del Castillo: #66. When I first read Dambisa Moyo's Lunch with the FT Interview in January 2009, her claim that aid had fostered dependency, corruption and poor governance in Africa was music to my ears. My book *Rebuilding War-Torn States* (Oxford, 2008) presented evidence that aid policies are in disarray.

Despite a few happy stories, my analysis clearly revealed a dismal record. Half of the countries in the transition to peace revert to conflict within a few years. Of the other half, the large majority end up aid-dependent. Improved aid effectiveness is critical to Africa, a conflict-prone region where conflicts are on the rise and aid dependencies are huge. After signing its peace agreement in 1992, Mozambique, for example, still relies on aid levels equivalent to roughly a quarter of its GDP.

A debate on aid and reconstruction such as the one that followed the 1948 publication of Allen Dulles's *The Marshall Plan*, as the US Congress was building support for the Plan, has been notoriously lacking in the post-Cold-War period. This is surprising, given that reconstruction is now taking place in the context of low levels of development, inadequate human capacity and institutional arrangements, and resource constraints. This makes large levels of aid simultaneously imperative but difficult to administer and channel effectively, transparently and without corruption.

The argument to stop aid to Africa is not new and was advanced by other African economists earlier. "For God's sake, please stop the aid" was the title of Spiegel's interview of James Shikwati in July 2005, when the G8 were about to beef up development aid to Africa in the Gleneagles summit. However, the extensive coverage of *Dead Aid* by William Wallis and others at the Financial Times has reignited the debate at a most propitious time.

What is surprising is how dogmatic, nationalistic and personal the debate has become. It is also surprising how little debate Dr Moyo's methodology and practices have generated and how little her economic and financial policy conclusions have been challenged.

Her definition of aid makes her methodology and policy recommendations questionable. Although this is hardly the venue to discuss this in detail, it should be clear that the "humanitarian or emergency aid," for which Moyo finds merits and therefore leaves outside her analysis, is often also a strong component of the "systematic aid" (grants and loans to governments) by which she is so troubled.

In Liberia, for example, well over a third of the net ODA to the government, amounting to 88 percent of GNI on average in 2006-07, was for humanitarian purposes. As Professor Jeffrey Sachs has argued, discontinuing this type of aid could have a devastating impact in some countries. It would be hard to argue that countries should tap the capital markets or other private capital flows to provide humanitarian assistance.

Moreover, Moyo fails to make the critical distinction between “humanitarian” and “reconstruction” aid that was critical to the Marshall Plan debate. In the present context, just as at that time, “humanitarian aid” to support basic consumption needs (food, shelter, medical care) should wither as soon as the population reaches minimum levels of consumption. Otherwise, it has proved to create serious distortions in price and work incentives that discourage production and increase dependencies. This has not happened and it is the main reason why dependencies in Africa and elsewhere are large.

Obviously the impact of “reconstruction aid” (or “development aid” in countries under normal development) will depend on how productively it is invested, and the impact it has on labor supply and on the exchange rate. This type of aid should be targeted at improving physical and human infrastructure and basic services, as well as creating employment.

As Nobel Laureate Edmund S. Phelps mentions in the Foreword to my book, the problem is that reconstruction aid has not been always directed toward “the reactivation of legitimate business enterprise and thus creation of jobs and increases in productivity”. As Phelps and I argued in an FT article on Afghanistan (January 3, 2008), reconstruction aid is necessary to turn the entrepreneurial spirit of the Afghans away from producing drugs and towards lawful production.

The same applies to Africa where aid should focus on fostering entrepreneurship and creating other jobs. The success of Rwanda in establishing a viable economy did not come about without aid covering roughly 95 percent of GDP in 1994 (falling to about 20 percent by 1999). To believe that other countries could come out of war and do without such aid—by borrowing from the markets or attracting foreign direct investment (FDI) or other private flows—is disingenuous at best.

Although the economic issues raised by Moyo’s book are too many to discuss here, some are quite puzzling. Why does she claim that aid to Africa has created Dutch disease (by appreciating the local currencies and discouraging domestic exports), given that the billions pillaged by the Mobutus ended up in Swiss bank accounts? Why is it not that remittances, which often account for a large share of GDP and remain in the country, do not similarly create Dutch disease?

Another issue that raises eyebrows is her dogmatic view that markets will solve all problems. She disregards ample evidence from Latin America and elsewhere where creditworthy governments and companies borrowed from the capital markets and tapped into other private flows and ended up in default or worse off as a result of poor investments, misallocation of resources, corruption, and market volatility.

But to end on a positive note, Moyo’s book has invigorated the debate at a critical juncture.

Amid the global financial crisis, and in the current environment of higher taxpayer scrutiny and significant competing needs, donors will be reluctant to commit large financial aid packages unless aid effectiveness increases—both in Africa and elsewhere.

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