

## Comments of the paper

“How to assess the need for aid? The answer: Don’t ask” by William Easterly

by

Giovanni Andrea Cornia

University of Florence

The paper I have been asked to comment upon is clear and well written, and has just been brilliantly and wittily presented by his author. As suggested by its ending - that argues it is impossible to estimate how much aid is needed to achieve the MDGs and that ‘the best plan is no plan’ – the paper is also provocative and deliberately aims at making us reflect on some recent development fashions.

The paper pivots around the following six main points: (i) any MDGs planning and costing exercise is futile, (ii) any approach at estimating the aid needs is dated and reflects a planning mentality that has been abandoned with the demise of socialism and the end of ‘development planning’, (iii) the economic models (such as the World Bank’s RSMS, the two gaps model, and the low-level equilibrium poverty trap model) on which the aid requirements are estimated are discredited and offer a poor guide to foreign aid policy making, (iv) there is no evidence that increased aid expenditure on health, education and other social areas improves the outcomes in these sectors, (v) where it occurs, development arises from the self-reliant efforts of “searchers” (firms, NGOs, communities, etc.) operating in free markets, (vi) the lack of development – especially over 1985-2000 – is not due to insufficient aid but to bad governance and corruption.

This line of argumentation provides some interesting insights, some of which are shareable. An important critique made by the paper is that halving poverty by the year 2015 can singlehandedly be achieved by raising external aid. Indeed, more and more, the development debate is being cast in terms of increases in aid flows for the achievement of MDGs, and therefore focuses almost obsessively on the setting of social goals, and their speed of progress, costing and monitoring. Such approach is reductionist and forgets the much more important changes that affect development, poverty, mortality, education and so on, such as deep technological change, an uncritical and often premature shift towards domestic and external liberalisation inspired by the ‘one size fits all’ philosophy, rising volatility, financial crises and so on. As observed by Lustig (2000), except for wars, the largest increases in poverty in Latin America during the last two decades were observed on occasion of financial and currency crises. Likewise, in Russia, male life expectancy at birth fell by three years in the aftermath of the financial crisis and the one hundred percent rouble devaluation of August 1998. How these and other changes can be ignored by the current MDGs approach – that implicitly treats them as white noise - remains a mystery to me. For these reasons, Professor Easterly’s critique is right on target: poverty, mortality and so on are in fact much more sensitive to macroeconomic, financial and technological changes (or their lack thereof) than to the aggregate volume of aid flows.

Yet, in my view, Professor Easterly’s paper can be criticised from a number of viewpoints. To start with, the paper attributes the slow growth recorded over 1985-2000 in several developing countries to bad governance and corruption rather to a host of other macroeconomic, microeconomic and institutional factors, some of which were mentioned above. To prove his case, Professor Easterly presents the results of a regression correlating negatively the growth in GDP per capita with the International Country Risk Guide Index (proxying corruption) and the Polity IV index (proxying the degree of democracy of a country). Such argument and evidence are unconvincing. While there is no doubt that bad governance and corruption are morally condemnable and that they hurt growth, they are unlikely to be ‘the’ cause – or even the main cause - of the slow growth observed in several

countries during the last two decades. To start with, his regression suffers from huge measurement problems. 'Bad governance' and 'corruption' are notoriously difficult to define, let alone measure, and – to the best of my knowledge - there are no widely agreed upon indexes to carry out serious empirical analyses in this field. Developing countries are particularly sensitive to the use of such indexes that are invariably developed by some Western institutions and that reflect Western values, ideologies and preferences for models of social organisation. Second, the empirical evidence about the relation between corruption/bad governance and growth is not very much in favour of Prof. Easterly's argument. The two fastest growing economies – China and India – are well known to be affected from major corruption problems, while democratic institutions in China are still in their infancy. Likewise the wunderkinds of growth of the 1960s and 1970s – Japan and South Korea – were characterized by a high incidence of paybacks on public contracts. And in Italy, while over the last 10 years the paybacks to political parties on public contracts have been drastically reduced, growth has slowed down markedly. Third, it is likely that Easterly's argument and his regression suffer from endogeneity problems. Even assuming that all measurement problems are solved and that the correlation results are robust, a negative correlation coefficient does not prove causality between "bad governance/corruption" and "slow/negative growth in GDP per capita". Most likely, the dependent and independent variables are simultaneously determined by third unobserved variables. If we consider the case of Sub-Saharan Africa, for instance, such third unobserved variable could be high illiteracy or low land productivity that simultaneously reduce growth in GDP per capita and the salaries of civil servants, who therefore asks bribes whenever possible.

The attribution by Professor's Easterly of the slow growth in the 1980s and 1990s to "bad governance/corruption" is all the more surprising in view of other recent writings of his that point to what I believe are more plausible causes of the poor economic performance in such countries. For instance, in a 2001 paper cited below he argues that countries with IMF-World Bank stabilisation and structural adjustment programs experienced a slower rise in poverty during periods of recession, possibly because of the cushioning of the crisis through Bank-sponsored 'social safety nets', but that these countries grew slower during spells of economic expansion in relation to that of 'home-grown' adjustment programs. And in a 2004 paper also cited below he questions the ability of the financial programming models of the IMF to guide stabilisation efforts and –by implication – long term growth. In brief, as suggested by the current debate on pro-poor macroeconomics and development policies (Cornia 2006), there are other, possibly more relevant, factors – including the nature of the macroeconomic policies followed and the neglect of agriculture – that explain the slow growth recorded by many poor countries over the last twenty years.

A second problem concerns the statement about the supposed lack of impact of aid and other foreign resources on growth in recipient countries. Here the paper probably suffers from aggregation bias. For sure, the paper is right in reminding us about the fungibility between external and domestic resources (as suggested by the often-observed substitution between external and domestic sources of investment finance), and in noting that greater aid-financed capital accumulation may be inefficient, leave growth unaffected and cause distortionary effects. Yet, as shown by the current debate on aid and FDI effectiveness, conclusions can hardly be generalized, as results depend on the concrete features of the foreign aid and other flows, their sectors of allocation, the domestic institutions that channel these resources, the incentives to act of donors and recipients, and so on. While in many cases an increase in external resources did not raise growth and reduce poverty, in many others it did reach these objectives. For instance, the transfers of 3-4 percent of their GDP for two decades to countries such as Spain, Portugal and Ireland certainly facilitated their convergence towards the average EU GDP per capita. Positive effects of aid and FDIs have also been observed in developing countries such as Mauritius, Malaysia and China (Cornia 2006) as well as Mozambique. The key question to be asked is not whether foreign aid (as well as FDIs and international loans) are effective or not but, rather, what is the nature of donors and recipients

incentives, domestic institutions, sectoral allocations of aid and FDIs, accountability mechanisms, delivery channels and so on that make foreign resources generate the desired effects.

A specific area where Professor Easterly paper's aggregation bias is particularly evident concerns the supposed lack of relation between aid-supported social expenditures and social outcomes. As rightly noted in his paper, most of the literature shows little correlation between aggregate health expenditure and outcomes. Yet, at the same time, there is solid evidence that primary health care interventions reduce rapidly infant and under-5 mortality rates (IMR and U5MR). Child immunisation is one of such interventions. During the 1980s, the governments of developing countries with the financial and technical assistance of a UNICEF (led by a visionary Executive Director such as James Grant) that provided aid for one-one and a half billion US dollars for the entire decade raised vaccination rates from 20-30 percent in the early 1980s to about 70-80 percent by the end of the decade. This programme, as well as other low-cost, high-efficiency interventions in the field of oral rehydration therapy against diarrhoea, the promotion of breastfeeding, pregnancy care, salt iodisation and so on reduced the number of deaths among children of under five years of age by an estimated three million units by the year 1990. This was the fastest decline in IMR and U5MR ever recorded in human history. And this was also a very cost-efficient form of aid. Indeed, if one assumes that the number of children lives saved increased arithmetically between 1980 and 1990, the total number of life saved during that period was 16.5 millions, entailing a foreign aid cost per life saved of 6-9 US dollar a year. While this calculation ought to include also the important inputs made available by governments and communities in the delivery of such programs, there is no doubt that such form of aid was effective and low-cost.

There are many other past and current examples of cost-effective measures that work well, including smallpox eradicating, the provision of basic drugs against tuberculosis, malaria, HIV/AIDS and upper respiratory tract infections, simple rural water-pumps that provide more than 20 litres of fresh water to each villager, micronutrients supplementation, primary education and textbooks provision, adult literacy, conditional transfers and basic professional training. In brief, there is a long list of interventions that have been shown to be cost-effective and to clearly improve social outcomes. The main problem is that less than 20 percent of both domestic social expenditure and foreign aid allocations are directed to such programs because of distorted incentives on both sides of the fence. In developing countries, domestic lobbies hijack a large part of health budgets to build expensive hospitals that care for the elites while donor support is often absorbed by activities (including the technical assistant bill for expatriate consultants) that have a limited health impact. Thus, the composition of aid and domestic social expenditure – rather than its level - is what matters for social impact. In this regard, the efforts of Professor Sachs in emphasising the need to increase aid to basic health, education and nutrition, in calculating the approximate foreign exchange component of such activities and in advocating a rise in such aid are very much needed. In fact he should be congratulated for his passionate advocacy in this area.

As noted, the main problem here is the political economy of donors and domestic actors, a topic that is discussed in other papers presented during this conference. Problems of tied aid, multiple principal-agents, lack of accountability, sub-optimal aid allocation between bilateral, multilateral and NGOs, donors coordination, proliferation of NGOs, inadequate program monitoring, short time horizons and so on erode aid effectiveness that is dependent on often unpalatable key choices in donor and recipients countries alike. Yet, for sure, we know that the basic aid programs provided by multilateral agencies such as UNICEF, WHO, IFAD, WFP, Oxfam, Save the Children and so on are quite effective and that the impact of these programs could be greater if the resources allocated to them were to be increased.

A third criticism that could be addressed to the paper concerns the demonisation of the world “planning”. For sure, Soviet central planning failed, and very much so. “Development planning” has also shown considerable limits and has been to a large extent abandoned. But the planning for the MDGs achievement is something much more limited, that does not require control of property rights, prices or resource allocation. It only entails a greater and longer term degree of organisation and preparedness for the activities that governments and aid agencies have to implement. State administrations, utility companies, national firms and multinational corporations have investment plans, personnel plans, research plans, marketing plans and so on that span several years. Also in the field of aid, most decisions require early preparations and action, careful multiyear planning and strict coordination between the actors involved. Projecting the future activities needed to improve the conditions of the poor is very much necessary and there is nothing discredited in this regard.

Does all this entail the setting up of large, costly and inefficient bureaucracies? Not really. The effectiveness of the UN, World Bank and bilateral donors can be vastly improved, though the problem lies in most cases not so much with the degree of competence and commitment of the staff but rather with the political approach the agencies are asked to adopt by the main actors. In addition, these are rather small bureaucracies. During my five years in Finland I was often reminded that the yearly budget of the WHO worldwide was smaller than that of the Helsinki Central Hospital. Neither seem the procedures set up to compute and monitor the overall costs of foreign aid and PRSPs particularly complicated when compared with the budgeting and administrative procedures adopted by even the most efficient and decentralized governments. Of course, here too the problem may lay not so much with the size of the administrators involved or how cumbersome their procedures are but with the top-down way these procedures may be implemented.

Finally, it is difficult to believe that poverty alleviation, mortality reduction, the eradication of illiteracy and so on can be solved by an approach inspired by the motto that ‘the best plan is no plan’. These problems result typically from acute market failures in weak states assisted by bilateral donors for which aid is often an instrument of foreign policy, promotion of domestic industry and pursuit of other national interests. The collective action problem in all the above areas is inescapable, though obviously difficult to pursue for the many reasons illustrated in Prof. Easterly’s excellent contribution. For sure the aid amount, type, sectoral and sub-sectoral allocation, delivery channels and incentives, as well as the accompanying macroeconomic and development require a serious debate, a diversity of approaches and, perhaps, also a bit of the healthy skepticisms that pervades Professor Easterly’s paper. To conclude, I think we do need a “Plan” though – as many have noted – such plan needs to be taken ‘seriously but not literally’.

## References

- Cornia, Giovanni Andrea (2006) “Pro- Poor Macroeconomics: Potential and Limitations”, Palgrave, June 2006
- Easterly, William (2001), “The Effect of IMF and World Bank Programs on Poverty”, paper prepared for the WIDER Development Conference ‘Growth and Poverty’ 25-26 May 2001, Helsinki.
- Easterly, William (2004), “An Identity Crisis? Examining IMF Financial Programming”, mimeographed, February 2004, New York University, New York.
- Lustig, Nora (2000). ‘Crises and the poor: Socially responsible macroeconomics.’ *Economia*, Fall, pp. 1–19.