The Case for Doubling Aid

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1 Introduction

With less than a decade until 2015, the Millennium Development Goals (MDGs) increasingly seem likely to be just another set of missed development targets. But is it really beyond our capacity to reduce under-fives deaths more rapidly, tackle income poverty and ensure that all children – girls as well as boys – have the chance to attend primary school? Surely these are not unrealistic aspirations? But if we are not currently on track to meet these targets, then clearly we are doing something wrong. Faddism in development thinking shifts the focus from one issue to another – we need better governance, less corruption, more community involvement, a greater role for the private sector, etc. – though with little apparent success in sustaining improvements in development effectiveness. Perhaps all that was needed all along was more money.

This article first reviews estimates of the resources required to achieve the MDGs, showing that there is indeed a financing gap. Critics argue that more aid will be ineffective. These arguments fall under three headings: (1) negative returns to aid; (2) lack of absorptive capacity (on the part of both donor and recipient governments) and (3) adverse incentives. These arguments are each dealt with in turn. It is concluded that there are no serious constraints on doubling aid, but that the type of aid matters (more of it should be explicitly pro-poor) and that some attention does indeed need to be paid to the recipient government's commitment to poverty reduction. But donors need to make changes in the type of aid that they give and the means by which they give it.

2 Needs-based aid requirements

Estimating aid requirements has a long history in the literature. The first model of aid impact, the two gap model of Chenery and Strout (1966), was based on work undertaken for the United States Agency for International Development (USAID) to estimate the amount of aid required by each country to sustain Gross Domestic Product (GDP) growth of 10 per cent.[1] Rather simpler versions of this model continue to be applied in the 'external financing gap' calculations made by the International Funding Information Services (IFIS) at country level.[2] A small academic literature has also continued in the tradition of gap models (see, for example Lensink and Van Bergeijk 1991), arguing the case for higher aid, though by the late 1990s more attention was focused on which countries should get aid, rather than how much in total.[3]

But there has been a burgeoning of estimates of aid requirements based on the cost of meeting the MDGs. Such estimates may be either 'top down', based on global, growth-based calculations, or 'bottom up' derived by aggregating sector and country-specific estimates.[4] The World Bank (Devarajan *et al.* 2002) used both approaches to get an estimate of the additional resources required of US$40–60bn, encompassing the Zedillo Report (United Nations 2001) estimate of US$50bn a year. These estimates are fortuitously, and perhaps suspiciously, close to the political call for the 'doubling of aid', which at the time was hovering around US$50bn a year. Other estimates come in with higher figures: for example, Vandemoortele's (2004) statement that spending on basic services (health, education and water) alone has an annual shortfall of US$80bn.

The immediate prospects for aid rising to match these requirements do not look promising. While from the mid-1970s to 1990 aid nearly doubled in real terms, it then fell in nominal terms: from a high of US$60.5m in 1992 to just US$48.5m by 1997. Since then it has recovered. Helped by the declining dollar, the total jumped to an all time high in 2003, of US$69.0m. But, this jump aside, the recent growth of aid has been insufficient to attain the levels which MDG-based calculations suggest is needed for the goals to be achieved.

Hence there appears to be a strong

developmental case for aid. The extra money may not be forthcoming on account of a lack of political will among donors. That is one matter. But are there also developmental reasons to advise against doubling aid? Here, three such arguments are discussed: (1) negative returns to aid, (2) lack of absorptive capacity and (3) adverse incentives.

3 Arguments against doubling aid – with rejoinders

3.1 Negative returns to aid

Economists believe in diminishing marginal returns. The more input you apply, the less productive it becomes: the return on the first million aid dollars is much higher than that on the 100th million. Diminishing returns may be so severe that they actually become negative: output actually gets lower the more input you apply. This idea became fashionable in the analysis of the macroeconomics of aid in the mid- to late 1990s. The infamous paper of Burnside and Dollar (2000, the one which claimed to show that aid only works when the policy environment is right) included an aid-squared term in their model, which they said showed negative returns to aid once it reached just 4 per cent of GDP: a share exceeded by many low-income countries, especially those in Africa. But aid and growth regressions are, as I have long argued (e.g. White 1992), notoriously unrobust and unreliable predictors of aid effectiveness. The analysis conducted by Robert Lensink and myself (Lensink and White 2001) put the threshold for possible negative returns at an aid share of around 50 per cent of GDP rather than 4 per cent[5] – and as a reviewer of that paper noted, the argument for negative rather than diminishing returns rests on rather few observations.

The econometric evidence is thus neither terribly persuasive nor capable of showing negative returns for a vast majority of aid recipients, even if aid were to be doubled. And even if the evidence were to indicate possible negative returns, it is still necessary to identify plausible reasons for this, which the econometrics cannot give us. There are two such arguments: (1) adverse macro impact of aid and (2) absorptive capacity constraints, which are discussed in the next section.

Some fear that there may be adverse macroeconomic repercussions from large aid inflows. Much of this comes down to whether the economy is demand or supply constrained. If the economy is supply constrained, then if aid is just increasing demand, it will be inflationary, resulting in an appreciation of the real exchange rate (i.e. aid as Dutch disease). But these inflationary effects are offset by three means: (1) the extent to which the aid is used in a way to alleviate supply bottlenecks (e.g. building infrastructure), (2) if the demand is met with imports and (3) if the aid is added to reserves with no increase in domestic money supply. As a result of these mechanisms, the actual inflationary impact of aid will be considerably muted in a supply-constrained economy. But if the economy is demand constrained (admittedly unlikely in most developing countries), then the aid provides a means of increasing demand. In general, it may be said that fears of adverse macro repercussions are overstated, though it does depend on how the aid is used.

3.2 Absorptive capacity constraints

The absorptive capacity constraint is the limited ability to use aid effectively. Simply stating it as such is a circular explanation of diminishing returns – aid has negative returns because of absorptive capacity constraints, which means a limit on the ability to utilise aid effectively. To have some explanatory power we need to elaborate on the nature of this constraint. Although attention has focused on absorptive capacity constraints on the part of the recipient, the real constraints may in fact rest with the donor, who may also generate the recipient 'constraint'.

Donor constraint means that the donor agency does not have the capacity to disburse or supervise a larger aid volume. The physical capacity to disburse cannot seriously be an issue – they just need to write bigger cheques, or a few more of them. The issue for donors is that they feel unable to supervise a larger volume of aid. Herein lies an argument that there may be negative returns – with weaker supervision, the recipient squanders the money on white elephants which prove to be a drain on resources. To accept this argument, one has to believe that developing country governments, 40 years on after independence and with 40 years of donor technical assistance, are incapable of spending money for themselves. This is the view that there is limited absorptive capacity in recipient countries, which I deal with below. But donors need to "lighten up". At best it may be that excessive monitoring on the part of donors, the "need" for which limits the amount of aid they can give, is unnecessary. But at worst, the excessive monitoring is the root cause of recipient 'incapacity' – as recipient government officials are too busy managing donors to spend time delivering government services. The harmful effects of donor proliferation have been well documented (e.g. Morss 1984). Proliferation comes both from donors spreading their aid over too many countries so each government has to deal with a plethora of different donors (see White 2002 and Acharya *et al.* 2004 for data and discussion) and from a reliance on aid projects rather than funding government activities, with separate reporting requirements for all of these projects. The latter problem is in principle dealt with through the use of sector programmes, though in reality many sector programmes actually comprise a large number of traditional project-style activities: the share of genuine budget support (sector or otherwise) remains low. Donor harmonisation, although once again on the Development Assistance Committee (DAC) agenda, has a long way to go.

Turning to recipients, the view that the real problem is limited absorptive capacity rather than limited resources, does not sit comfortably with what one sees on the ground in terms of schools with inadequate furniture and textbooks, clinics without drugs, poorly maintained roads, rural areas in need of infrastructure or urban settlements in need of water and sanitation. There is need everywhere, and meeting these needs is what achieving the MDGs is about. But, it is argued, it is no good throwing money at these problems, since the line ministries do not have the staff able to handle implementation of these programmes. This may have been true in some countries 40 years ago, but is far less credible today when professional level government staff are educated to at least degree level, and many, even in district offices, have Masters degrees from universities overseas. Travelling throughout several countries, I have been consistently impressed by the dedication, motivation and ability of staff in district offices. If they are not performing their functions to their fullest ability, it is because they do not have the resources to do so, not because they do not have the ability. One story illustrates this point.

The social fund in Zambia hands money directly to community-level project committees to purchase materials and hire contractors to build new school blocks and health clinics. But district officials are responsible for monitoring the construction of these buildings. The District Education Buildings Officer in a district in central Zambia indicated that he probably spent half of his time visiting construction being financed by the social fund, or checking on maintenance arrangements in recently completed facilities. When asked if this did not take him away from doing his job (as critics of social funds are always looking for arguments that these funds undermine government) he replied 'but this *is* my job. Before the social fund there was nothing to do and I sat around reading the paper. I am a Buildings Officer and now, because of the social fund, there are buildings for me to inspect'. The availability of resources has harnessed the untapped skills of this professional, and many others like him across the country.

This Buildings Officer is but just one example of literally thousands of underemployed officials in government offices across the developing world. Diminishing returns occur because an input becomes too abundant relative to the other inputs. But the labour to administer increased aid flows is not in short supply, especially if it is channelled through district offices which, after some years of decentralisation, are well staffed in terms of both quantity and quality. There is no shortage of staff to give immunisations, supervise school feeding programmes using locally procured food stuffs, and administer conditional cash transfers. The constraint is the lack of resources both to finance these programmes and the small amounts required for these officers to be able to visit the field frequently enough to run programmes.

There is no shortage of project-level evidence that aid-financing of such programmes has beneficial effects. For example, Bangladesh, a country deemed to have a corrupt government and an inefficient bureaucracy, has achieved dramatic reductions in fertility, through a government-run family planning programme, and under-fives mortality, partly through government-delivered immunisation. That there are fewer success stories may be because of donor propensity to spend on the wrong things – most notably technical assistance. *All* of USAID's support to education is technical assistance, for example a project in Ghana provides training to teachers to put desks in circles rather than rows and to display posters on the wall. There may be good pedagogical reasons for this, but it is of little help in the large number of schools in poor areas that do not even have desks. In the words of one teacher: 'I'd like to put posters on my classroom wall, but I don't have any posters. In fact, as you can see, I don't have any walls' (quoted in Kraft *et al.* 1995).[6] Similarly, the belief in the importance of social capital is prompting a trend to spend aid money 'teaching people to hold meetings', which flies in face of both the theoretical and the empirical evidence that community organisation is a latent resource mobilised by accessing external resources[7] – as the case of social funds in Zambia has shown.

But if many project financed activities appear to go well, why will aid not help? The final argument against giving more aid is that there will be adverse impacts on the general policy environment or on government spending patterns (fungibility).

3.3 Adverse incentives and fungibility

This brings us to adverse incentive arguments, which claim that awarding aid on a needs basis will encourage countries to remain needy. This means that allocating aid to, for example, countries with high infant mortality provides an incentive to not reduce mortality. Putting it like this, I hope makes it sound as implausible as it probably is. However, proponents of this view suggest two channels through which it may operate. The first is that governments may postpone necessary policy changes so that aid props up inefficient policy regimes. The second view is that if aid finances developmental activities, then the government will use its own resources for less desirable activities. These arguments are dealt with in turn.

The argument that aid discourages policy change has less force today than it might have had 10–15 years ago, since nearly all countries in the developing world have undertaken massive policy change during this period and are not today beset by what are deemed to be 'bad policies'. This is not to say that aid has been responsible for these changes. The 'failure of conditionality' is now a byword in the literature (e.g. Killick 1998; White and Dijkstra 2003). One reason for this failure is that it is domestic politics, not aid, that drives policy change; in the words of Killick: 'domestic political calculations dominate decisions about economic policy and donor agencies are relatively powerless in the face of this' (1998: 151–2). In other words, even if cases of bad policy can be found, it is only rarely that aid will affect these policies for better or for worse.[8]

Returning to our mortality example, suppose the government withdraws its own resources from, say, immunisation, if aid is available to finance it. There are two ways to address this problem. The first is monitoring the use of aid funds and the second more general, monitoring of government spending, thus introducing an element of conditionality or selectivity. These arguments require elaboration, since they are an important part of the case for expanding aid.

There are many things which can be done to assist countries to meet the MDGs: help achieve full immunisation coverage, especially in Africa where it has stagnated at unacceptably low levels; support various means of getting children in school, such as school rehabilitation and conditional cash transfers, and to improve the quality of schooling, supporting textbook provision and incentive payments to teachers in rural areas, school feeding programmes; small-scale rural infrastructure and so on. The papers in the book edited by Richard Black and myself (Black and White 2004) identify many publicly supported actions and programmes that can be undertaken to achieve the MDGs. Very many of these things are not being done at present. If aid finances a new activity, then there is no scope for fungibility, so that monitoring that aid is used for the intended purpose is simply a matter of verifying project outputs, which is routinely done by all agencies. However, there are some things that donors finance which the government might also do. In this case, the aid is fungible – it has to be so unless the donor finances something the government would never dream of doing (in which case it is a bad government, or the donor wants to fund something the country does not really need – which may be true of most technical assistance). The response to fungibility is to monitor the government's use of its own funds. If the government is "bad" and not spending on the right things, then project aid can be given, since it will not be fungible – of course there may be governments which are so hopelessly corrupt that aid should not be directed through that route at all, though there may be a case for aid through non-governmental organisations (NGOs). But if the government is already spending on the right things, then aid will be fungible, but so what? Indeed why give such a country project aid at all – since the government is using its own resources wisely, why not simply supplement those resources with budget support?

There is an 'ideal type' here of aid disbursed entirely through budgets spent on government programmes, and monitored and evaluated as part of the government's own accountability system. That reality falls so far short of this ideal type is the fault of donors not recipients.

The above argument appears to endorse either *ex ante* conditionality – giving money conditional on countries adopting the right policies – or *ex post* selectivity – giving money to those countries which have adopted the right policies. This is so, but what is being supported departs considerably from current donor practices in conditionality, and the tendency of donors to micro-manage the policy process. It is far from clear that donors know what is best for developing countries, so there can be disagreements as to the appropriate policies to adopt, and the right composition of government spending. Two related changes are required on the part of donors. The first is to act with a bit more humility in policy dialogue – so it does indeed become a genuine dialogue in which donors may help support public spaces for policy debates, rather than dictate the outcome of those debates in a one-sided policy monologue (see White and Dijkstra 2003, for an elaboration of this argument). The second is to reserve variations in aid for obvious departures into bad practice, i.e. excessive conspicuous consumption on the part of government, or spending patterns which are insufficiently pro-poor.

Pro-poor spending is not an area in which donors have themselves excelled. Estimates (e.g. White 1996) suggest that less than one-fifth of aid is spent in a way that directly benefits the poor. There is clearly scope for improvement. Here, incentives do play a part. If the donor provides incentives to design aid programmes in ways that will not benefit the poor – excessive funding of workshops and overseas travel – then it should be no surprise that government officials take advantage of it.

4 Conclusion

It has been argued here that a financing gap exists in the sense that additional funds are required to assist countries to attain the MDGs. There is no shortage of things which may be financed with these resources: immunisation, school rehabilitation, school feeding programmes, rural infrastructure and so on. The various arguments as to why aid should not be increased are dismissed, though there are implications for aid management. More aid should be used for activities which directly reduce poverty, with more emphasis on providing goods and services for the poor and less on technical assistance. But as far as possible, aid should fund government-executed programmes, rather than work on a project basis.

Notes

1. At present, 5 per cent is seen as a respectable target, but in the 1960s many developing countries were achieving growth rates higher than this.
2. For critical views of the use of this model by the IFIS, see Tarp (1993) and Easterly (1999). For a defence, see Ranaweera (2003).
3. That is, the prescriptive aid allocation models (discussed below) take the total aid budget as given.
4. For an excellent review of methodologies and some estimates see Heuty (n.d.).
5. We also point out that the Burnside and Dollar estimates use PPP GDP, so that at actual exchange rates their 'turning point' is at just under 20 per cent of GDP.
6. World Bank (2004) presents evidence on the importance of school building and textbook supply for school attainment and achievement in Ghana, and that some schools remain deficient in availability of these and other inputs.
7. See White (2003) for a game theory model showing how external finance generates community participation, and Krishna (2002) for the argument that having someone who can access external resources is what makes the capacity to organise important.
8. A related argument is the view that aid will only work when the policy environment is right, i.e. the view put forward in the World Bank's *Assessing Aid* report (World Bank 1998). This analysis has been heavily critiqued on many grounds (e.g. Lensink and White 2000).

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